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The Mortgage Banker

Course I, School of Mortgage Banking, 1961 Northwestern University

Course II, School of Mortgage Banking, 1961 Northwestern University

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MBA · MORTGAGE BANKERS ASSOCIATION · OF AMERICA

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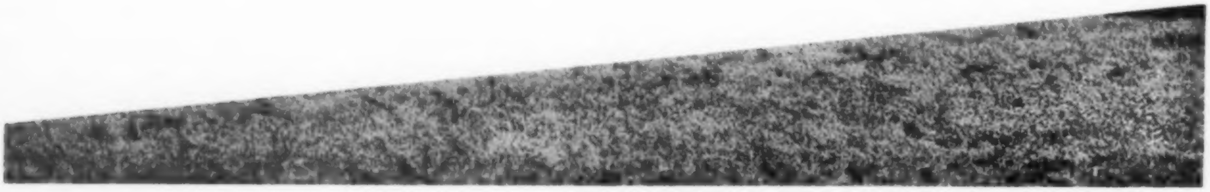
INFLATION? DEFLATION? WHICH ONE?
STATE LAWS & MORTGAGE INVESTMENT
THE TAX ASPECTS IN STOCK OF FNMA

A view of one of the many beautiful horse farms near Ocala, Florida



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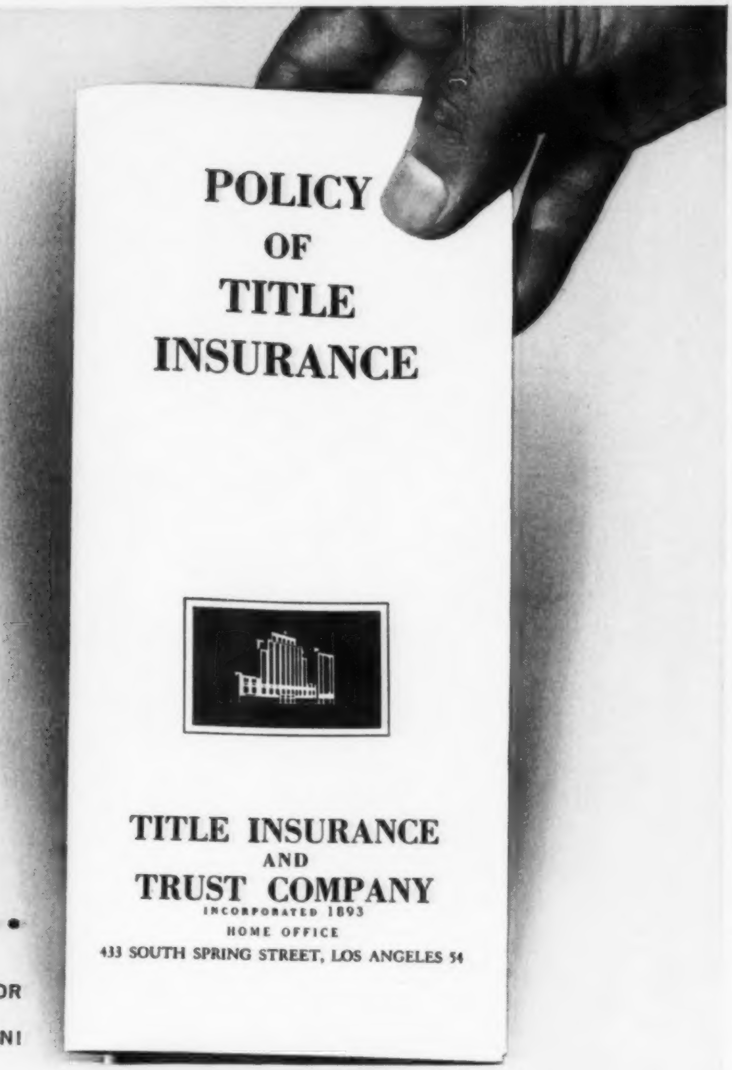

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MBA CALENDAR

September 11-14, National Electronics Convention, Statler Hilton Hotel, Detroit

September 15, Sheraton Chicago Hotel, Chicago, Mortgage Seminar for Trusteed Funds

October 30-November 2, 48th Annual Convention, Americana Hotel, Miami Beach, Florida

December 10-16, Second Annual Case-Study Seminar on Income Property Financing, Michigan State University, East Lansing, Mich.

President Tharpe's Calendar

October 13, Mortgage Division Kansas City, Mo. Real Estate Board, Kansas City

October 15, Mississippi Board of Realtors, Jackson, Miss.

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GEORGE H. KNOTT, *Editor* · ROBERT J. BERAN, *Associate Editor*

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Contents

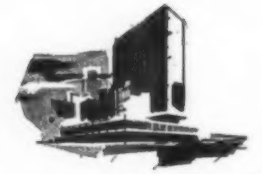
MID SUMMER 1961: Along about this time of year, interest in business meetings usually hits a low but not so in 1961 as far as MBA is concerned. Two are coming up on the Association's schedule within the next several weeks, one of direct importance for members and the other of long-term benefit for them. *(See page 33.)*

Then, of course, there is the MBA annual Convention not too long after these are held and that's something every mortgage man ought to make an effort to attend because it is one of the most valuable parts of his Association membership. *(Also see page 33 for some comments. Next month in these pages will be reported the complete details of what is ahead in Miami Beach October 30-November 2.)*

Have you made your own plans to attend the Convention? If not, we suggest you delay no longer but contact the National Office for all information. It's going to be the largest MBA meeting and, we believe, the most important.

REAL ESTATE IS BOOMING BUT WHAT ABOUT—

The Coming Bust in the Real Estate Boom



By DANIEL M. FRIEDENBERG

Few pieces of contemporary writing concerning the field of real estate have aroused the heated discussion created by the following article by Mr. Friedenberg in the June Harper's and which appears here in condensed version with special permission. Many people, groups and publications have roundly criticized the conclusions which he has drawn. Presentation of his observations implies no endorsement of the facts he cites or the opinions he expresses—he has set forth some views which we thought you would be interested in seeing. Portions of what he says, however, give a picture of many aspects of how the face of Urban America is being changed, the tremendous surge of building we are experiencing and some of the factors which have been important in this development.

One need not agree entirely with the conclusions to appreciate the views concerning one of the really big developments of our times, the great revolution in city real estate.

REAL estate is booming. The face of America is being lifted by violent surgery as hills are leveled and swamps are filled, and every city stretches out eager fingers to engulf its suburbs.

New York City stands in the forefront of this tremendous wave of construction. An unending parade of new edifices joins the skyline, from the heart of old Manhattan to the farthest reaches of the Bronx. Old trees on side streets and de luxe young buildings on Park Avenue enter the same insatiable maw—neither can resist the onslaught of that new titan of America, the real estate speculator.

This awesome eruption of concrete and steel must bewilder the mind of the spectator. Why are stately buildings three decades old uprooted for ribbon-windowed office structures? Why are massive apartment houses crowded jowl to jowl, blocking out air and light in a city short of both? And most of all, where do the tenants come from to fill the never-ending waves of new apartments and office buildings?

As a professional real estate man, I have myself participated in this postwar building frenzy from its inception. I saw it start when the city woke from depression lethargy and the immobility of the war to erect housing for the generation of war marriages and to build office buildings with the new improvements of air conditioning, acoustically "hung" ceilings, and recessed fluorescent lights. I have seen the maturity of the boom, as shifting racial populations have altered the character of whole boroughs and the needs of expanding business have brought out-of-town companies into the metropolis. And now I have begun to observe a repetition of the disastrous overbuilding of the 'twenties—an overbuilding which poses dangers to the stability of the nation's economy.

Behind this massive boom stands an intriguing figure, the real estate speculator. He is one of a new group of multimillionaires who have risen to the forefront of the American scene. These men have been able to gain enormous wealth and power essentially because the building industry in our society has become a favored industry, depending on tax and other benefits in much the same

way as the oil industry depends on its depletion allowance.

This article will show how the real estate speculators have been able to make fantastic profits by using this favored treatment; expose some of the tricks they have hatched to milk the system to the utmost; and outline some of the dangers that are involved as a consequence.

Throughout American history great fortunes have been made in real estate but the very basis on which vast sums have been acquired in recent years has been changing. What is taking place is a shift of emphasis from land speculation—the purchase and resale of ground—to the leasing of land for purposes of building—a tactic which the tax structure has made far more profitable, as we shall see.

This is a change of historic proportions. Land speculation has been one of the traditional routes to social and political, as well as financial, success in America. Washington augmented his family's fortunes by speculating in frontier lands and the family of our latest President has followed somewhat the same pattern. New York, of course, has been an ideal site for real estate activity, and the wealth of many famous old families—Astors, Goelets, Rhinelanders, and Schermerhorns, among them—was largely based on profits made from land during the huge expansion of the city during the early nineteenth century. Dozens of now-prestigious names soon followed. The first Marshall Field—who made a large part of his $100 million in land speculation—went so far as to say: "Land is not just a good way to make money . . . it is the only way to make money."

The basic strategy of all these land speculators is illustrated by the possibly apocryphal statement made by John Jacob Astor when, in 1810, he sold a Wall Street lot for eight thousand dollars—a low price for the time. "I shall," he told the buyer, "take these eight thousand dollars and buy eighty lots above Canal street; by the time your one lot is worth twelve thousand dollars, my eighty lots will be worth eighty thousand."

Essentially the same technique was used by hundreds of speculators to make enormous profits in New York after World War II, when the metropolitan area spread beyond the five boroughs and land values exploded. For example during the 1930s my father—a realtor since the first world war—had invested in the swampy lowlands around the projected site of the New York World's Fair on Long Island. He bought the land by the *acre* and, ten years later, sold by the *yard*. Around 1949, the late Sam Minskoff, a well-known builder, bought the same property by the *yard* and after five years was able to sell it by the *foot*, making far more money in half the time. And this transaction occurred before the last decade, when over two million people fled the city for the suburbs—making millionaires out of dozens of Long Island potato growers in the process. Last August, the magazine *House and Home*, a publication of Time Inc., estimated that since World War II, land speculation has created more millionaires than any other form of business investment.

Nevertheless, most of the big money in real estate is not entering land speculation at the present time (although of course enormous profits are still made by owners holding property in strategic spots). Those with large capital are aware that land values have soared to such inflated levels that speculation often involves dangerous risk. But another, and more formidable reason is that waiting for land to increase in value requires patience. Ten years, even five years, is too long for the acquisitive to wait, if money can be made more quickly.

Because of the tax laws, it can. The government has taken the position that since buildings grow old, a certain part of their cost should be allowed as a tax-free deduction each year. For example, if a building has an estimated life of fifty years, the government allows the owners to deduct one-fiftieth of its cost each year as a credit against its supposed loss in value. This is called a deduction for the "depreciation" on the building. But the tax authorities refuse to allow tax deductions for depreciation on land itself, following the sound theory that land does not wear out. Tax "angles" override all other factors for most big investors today, and investment in land for the sake of future growth in value is limited either to very small endeavors or to the extremely powerful who think in terms of building their fortunes over the decades, rather than their annual tax returns.

Certain old estates continue to take the long view: the Astors and Goelets are still with us. The Astor Estate, for example, anticipated the development of Park Avenue as a financial community and purchased several large plots between 46th and 59th Streets in the 1940s. It is now investing in land to the east of Park Avenue in the Fifties, while the Goelet heirs have acquired a large plot directly facing the Lincoln Square project.

No special genius was required to foresee such developments. The future of the Park Avenue area above Grand Central has been clearly understood by big investors for a long time. And it is still possible to buy land near Lincoln Square for $35 a square foot which should easily triple its value in a decade. A corporation affiliated with my own real estate office purchased a brownstone house in the Lincoln Square area in 1957 for $35,000. Last year it bought two more at a price 30 per cent higher. Recently it offered $60,000 for another brownstone on the same block and was turned down flatly. But the new moguls of real estate consider these deals petty and regard a profit of 30 per cent over three years as only 10 per cent annually—small pickings by their standards and a waste of their time.

They know that far more money can be made by *leasing* land, and the old estates and settled rich now prefer to lease. In this way, both sides in the transaction gain huge advantages. The party that originally owns the

land receives from his lease a yearly income based on its inflated value. He risks no capital and, at the end of the lease period, not only the land but the buildings constructed on it will revert to him.

But the party that benefits tremendously in the short term is the man leasing the land for building purposes. The "new millionaires" of real estate—men like the Uris brothers, Erwin Wolfson, and the Tishmans—have gained enormous fortunes in short years by acquiring leases and exploiting their unique advantages. And these advantages spring chiefly from the tax laws.

Let us see how it is all done.

The key tax gimmick used involves "depreciation." When a person leases land and then builds on it, he can deduct from his taxable income not only the rent he pays to the ground landlord but also an additional sum representing the depreciation in the value of the building itself. But how is he to calculate this depreciation? Until 1958 the government held that, during the first term of his lease, he could deduct as depreciation *the entire original cost of the building.* Thus, if he leased the land for twenty-one years—the usual first term—he could deduct from his taxable income each year nearly 5 per cent of the building's original cost; at the end of twenty-one years he would have deducted 100 per cent, or the entire amount. (This law has since been changed but the same result can be obtained in a majority of cases by manipulations too complicated to describe here.)

In itself, this depreciation allowance is an enormous advantage to the man who leases and then builds. But the government allows a further tax benefit called "accelerated depreciation." This means that the largest part of the building costs are tax-deductible during the early years of the lease. One favorite method is to double the amount deducted for depreciation during the first year of the lease and then deduct progressively smaller amounts in each following year. Thus

if the lease runs for twenty-one years, the builder will be able to deduct from his taxable income close to 10 per cent of the original building costs during each of the first few years.

But this is not all. Although the builder is allowed to deduct as depreciation the entire original cost of the building, in fact he seldom if ever puts up more than a third of this cost from his own funds. He generally borrows the rest by obtaining one or more mortgages. So, in effect, he is given the benefit of a tax-free allowance based not only on the cash he invests but also on the mortgage money loaned by others. Thus, in the example above, the builder is seemingly allowed a tax deduction amounting to nearly 10 per cent of his original building costs; but in reality his deduction in each of the first years of the lease will amount to nearly 30 per cent of the cash he actually invested in the building out of his own pocket. And he will subtract this huge sum from his taxable income before figuring his ordinary profits from rentals.

Is it any wonder that New York—not to mention other cities all over the country—is rebuilding at such a frantic rate? The accelerated tax-free depreciation allowance conferred on the builder by the government makes it possible for him to recover his building costs quickly—even before he calculates his profits from rents.

Only recently the government authorized the use of yet another device which permits builders to pile up both profits and buildings in rapid succession. This is called the "collapsible corporation." If a builder liquidates—or "collapses"—his corporation after holding a piece of property for a minimum of three years and a day, the government merely imposes a capital gains tax of 25 per cent on his profits when he sells, instead of the regular 52 per cent tax which corporations must normally pay. Thus, after the builder has reaped large profits through both his rents and the use of the accelerated depreciation allowances of the tax laws, another special tax law permits him to get rid of the building while paying less than half the taxes levied on other businesses when they make a profitable sale.

Let us take an actual example. Some years ago a man I know leased ground in order to build an apartment house in the East Fifties. As usual, the first term of the lease was twenty-one years. He borrowed money from an insurance company to finance what he alleged to be 65 per cent of the building's cost. But in reality, the sum he got covered 80 per cent of the money required. (His architect and engineer had to back up his inflated estimate of the funds needed or they would not be hired for his next job.) Then, having paid only 20 per cent of the building costs with his own money, he claimed and received "double depreciation" on the completed structure—*i.e.*, he was allowed to deduct from his taxable income that year an amount close to 10 per cent of the cost of the building structure.

By taking these annual tax deductions, this builder saved a sum of money nearly large enough to repay

his original investment during the first three years of ownership, above and beyond his profits from rent. He then sold the apartment house, liquidating his corporation in order to pay a single capital-gains tax on the high profits. This sale returned his investment to him a second time, and the additional profit was subject only to a tax of 25 per cent.

If the speculator can manage to build as an individual or a partner, and not as a corporation, his profits are often enhanced again. He can deduct the annual depreciation from his personal income which is usually taxed at a higher rate than a corporation's.

It will readily be seen that, in the world of builders, the great trick is to invest as little as possible during construction and bale out as much as possible after completion. If only he can get his hands on some cash, the builder reasons, he can start mortgaging and borrowing and getting the building up—and then the tax gimmicks will pull him through.

Obviously it is attractive to him to lease land, instead of buying it—he doesn't tie up money in the land itself. It is also advantageous to build "co-operative" buildings where the tenants buy their space outright—the builder knows he will immediately get his money back, plus profit, as soon as the building is completed. But precisely because such large amounts are involved, cash for investment is chronically in short supply, and the speculators often put together tense financial deals of enormous complexity, frantically borrowing, mortgaging, negotiating with banks and insurance companies to keep their projects afloat.

Sometimes the day is saved just when the situation seems most desperate. In the tight money market of 1956 two New York builders—both old and well-known building families—were staggering under the burden of financing construction of two large midtown office buildings: the Tishmans were building at 666 Fifth Avenue, the Minskoffs at 575 Lexington Avenue. But the Prudential Insurance Company obligingly decided to buy both of the buildings before they were completed and lease them back to the builders for many years. Both the Tishmans and the Minskoffs made large sums operating the buildings, which, however, belong to the insurance company. Recently the Minskoffs sold their operating lease to raise money for construction of their new skyscraper at 250 Broadway, facing City Hall.

What must concern the public most, however, is not the private business style of the big realtors, but the ways in which their operations affect the city. Here, the career of that amazing modern manipulator, Mr. William Zeckendorf, is particularly relevant, for since the early 1950s Mr. Zeckendorf has evolved a new and ingenious approach to financing which has had far-reaching effects on New York.

This wizard found the typical operations of real estate men amateurish. When they bought a piece of property they calculated essentially in terms of the amount of their own money they would have to invest, on the one hand, and the amount of the mortgage money they would have to borrow, on the other. Zeckendorf was the first person to understand fully that an improved property is a unit consisting of many parts: the land, the building itself, the income derived from rent, the additional mortgage value of the rents isolated from the building. And he saw a way to exploit each of these values separately.

Mr. Zeckendorf first applied his new technique to the building he owned at 2 Park Avenue. By traditional standards, the building was worth somewhat less than $10 million. First he sold an operating lease—the

(Continued on page 38, column 1)

WHICH WILL IT BE

INFLATION?

DEFLATION?

INFLATION

Is the threat of inflation a thing of the past? The warnings as to what inflation would do to the nation's economy are heard less frequently now and the opinion seems to grow that this is a problem that has been met and solved. But is it? Just what are the prospects for more inflation in this decade—and what are the reasons for thinking that it will be deflation instead? What's the accelerated defense program going to do? Dr. O'Leary presents the case for each point of view

DOES INFLATION or deflation lie ahead? What are the chances of achieving a reasonably stable price level? This is a vital question especially because the maintenance of general price stability is essential to a vigorously growing free economy such as ours. It is pertinent to observe at the outset that there are fashions in economics just as in women's hats. In 1959 it was fashionable for economists to worry about the inevitability of "creeping inflation" and the "cost push."

Today inflation fears are out of style. The "creeping inflationists" have been displaced by the "neostagnationists" and the fashion with many economists is to worry about chronic slack in our economy, if not actual deflation. Fashions tend to repeat themselves, and I suspect that by next year preoccupation with creeping inflation will be back in vogue.

My thesis is divided into three parts:

▶ The several reasons that are being advanced for believing that inflation is not in prospect in the early 1960's;

▶ Several reasons for believing that inflationary pressures may reappear in the next few years; and

▶ My own conclusions about the prospects.

First, the reasons that are being advanced for believing that inflation is not likely to be a problem in the early 1960's. One is the view now being advanced by many influential economists that we have reached a stage in the development of the American economy in which chronic slack is our real problem. It is argued that, due to an unsatisfactory growth rate of the American economy in the past several years, there is a pronounced tendency for unemployment of labor and plant to remain at an abnormally high rate even at peaks in the business cycle. It is further argued that at full employment of our labor force the American economy could achieve a gross national product today of $550 billion, whereas the current rate of GNP is nearly $50 billion below this potential.

Evidence to support the idea of chronic slack is found in the high rate of unemployment of our labor force and in the comparatively low rate at which industrial plant capacity is now being utilized. The seasonally adjusted rate of unemployment in April was 6.8 per cent of our labor force, and the recent McGraw-Hill Survey indicated that at the end of

By DR. JAMES J. O'LEARY

Director of Economic Research, Life Insurance Association of America

1960 manufacturing companies were operating at 77 per cent of capacity, as compared with a preferred rate of 94 per cent.

Those who are impressed with the "production gap" or "neostagnation" theory argue with some force that our economy is certainly not vulnerable today to a renewed rise in the general price level. They would go beyond this and contend that, in the absence of rather powerful expansionary fiscal and monetary policies by the federal government, our problem is more likely to be deflation.

The big question, of course, is whether we are faced with chronic slack in our economy at the present time. There can be little doubt that an economy plagued by a high rate of unemployment and a low rate of utilization of plant capacity is not a likely breeding ground for inflation. It seems clear that under conditions of high unemployment the wage-push is not encouraged because of the weaker bargaining position of organized labor. Similarly, with substantial unused resources it is difficult to visualize a resurgence of inflation of the demand-pull variety. Therefore, crucial to the question of whether inflation or deflation lies ahead is whether we are today plagued with chronic slack or whether we are now merely in the early up turn of a mild business cycle with the prospect of a vigorous recovery.

Another argument advanced by those who are convinced that inflation is not ahead of us in the early 1960's is that much of the inflation since the end of World War II is traceable to huge pentup demands for housing and durable consumer goods built up during the war, along with a corresponding buildup of liquid asset holdings by individuals, and that by now this backlog of demands has been pretty well satisfied. There can be little doubt that the backlog of demands stored up as the result of the war, and the accompanying accumulation of liquid assets in the form of cash, demand deposits, savings deposits, U. S. savings bonds, and so forth, have been part of the explanation for the inflation we have experienced. Moreover, it seems clear that certain backlogs of demand are pretty well satisfied, at least for the time being.

"... the danger of renewed inflationary pressures in the early 1960's is a real one ... The natural forces of general business recovery now beginning to show themselves, plus government, fiscal, monetary, housing, and other policies aimed at achieving full employment and faster economic growth, could easily revive the forces of inflation by the second half of 1962. It is significant that inflationary booms are usually traceable to such factors as large Federal deficits and excessive liquidity resulting from policies adopted in business recession but delayed in their impact until the boom phase of the cycle. So far we have seemed to avoid this danger of being too heavy-handed in the recession, thanks to the limitations placed upon expansionary policies by the international balance of payments and gold outflow problem, but it remains to be seen whether we shall continue to have such admirable restraint."

For example, it is becoming more and more apparent that for the first time in 15 years residential construction cannot be easily stimulated by readily available mortgage credit on liberal terms. Pockets of unsold houses and higher vacancy rates for apartments suggest that the limiting factor is demand and not availability of credit. Similarly, the general public has obviously become much more discriminating in the purchase of automobiles as unsatisfied backlog demands have disappeared.

Another argument advanced by those who minimize the danger of a recurrence of inflation in the next few years is that we have now learned how to employ monetary and fiscal policies effectively to prevent any new buildup of inflationary pressures. Great emphasis is being placed on the view that our Federal tax system is now geared to produce a substantial cash surplus prior to the onset of inflationary pressures and thus provides a powerful safeguard against rising prices—if not actually a deflationary brake on the economy. Moreover, it is argued, the monetary authorities have demonstrated a willingness to use their powers vigorously to combat inflation.

Finally, it is argued that the discipline of foreign competition now provides a strong guarantee that no responsible U. S. government can tolerate another round of inflation. The reasoning is that the U. S. has become the banker for the free world so that the dollar must be kept strong. This means that we must take the basic steps necessary to correct the large unfavorable balance of payments situation we have experienced in recent years.

Of prime importance, we cannot afford to let further inflation in this country price us out of foreign markets and thus improve the competitive position of foreign producers in the American markets. Moreover, we cannot afford to permit the threat of further inflation in the U. S.—and the accompanying fear of devaluation of the dollar—precipitate a new outflow of short-term liquid asset holdings of foreigners. Thus, it is argued forcefully that our balance of payments situation and our responsibilities to the free world preclude resort to inflationary policies by the Federal Government in the foreseeable future.

These, then, are some of the more important reasons advanced by many economists to the effect that there is little prospect that inflationary pressures will recur in the early 1960's: (1) the development of chronic slack in our economy as evidenced by a high rate of unemployment and a comparatively low rate of plant utilization; (2) the exhaustion of the backlogs of consumer demand and liquid assets built up during the war; (3) greater knowledge of how to use fiscal and monetary policies effectively as a brake on inflationary pressures; and (4) the discipline of foreign competition.

This is undoubtedly an impressive array of arguments even if one is skeptical of the "neo-stagnation" theory.

Before we become too complacent about the danger of further inflation, however, it will be helpful to consider some of the reasons for believing that inflationary pressures may reappear in the early 1960's. First, it will be useful to ask whether the American economy does face a problem of

chronic slack, or whether the business recovery now starting will be strong enough to regenerate inflationary pressures.

As Arthur F. Burns pointed out recently, when the theory of chronic slack, or the "production gap," is subjected to analysis, the evidence rests fundamentally on one fact, namely, that the cyclical expansion of 1958-60 was exceptionally short and incomplete so that when the expansion ended our economy was still some distance from full employment. Burns suggests that there is a better explanation for the incomplete recovery of 1958-60 than that given by the "neo-stagnation" theory. This explanation lies in three developments which occurred during the expansion phase, as follows:

▶ Between the first quarter of 1959 and the third quarter of 1959 the Federal cash deficit fell from an annual rate (seasonally adjusted) of $17 billion to $2 billion, and by the second quarter of 1960 there was a surplus at an annual rate of $7 billion; thus, in a period of little more than a year, we had a turnaround in Federal finances of $24 billion, which undoubtedly exerted a strong braking effect on business expansion;

▶ The monetary authorities at the same time proceeded vigorously to restrict credit expansion, so that by mid-1959 the commercial banking system had net borrowed reserves of over $500 million and the money supply had stopped growing;

▶ The protracted steel strike in the second half of 1959 contributed significantly to the incompleteness of the business expansion of 1958-1960 in several ways; anticipations of the strike first led to a sharp buildup of inventories and boom psychology in the Spring and early Summer of 1959; once the strike arrived and continued to drag on, it caused both "concern and confusion" in the business community and led to some hesitation in placing orders for investment goods; it also obscured early recognition of the magnitude of the fiscal and monetary restraints that were being imposed by government on economic expansion; and when the strike finally ended, many business concerns proceeded to practice new economies in managing their inventories.

Burns concludes, therefore, that the incomplete expansion of 1958-60 was due not to chronic slack but rather to special factors that need not be repeated in the next period of expansion.

In addition, some economists are skeptical about the figures on unemployment of labor. I refer here not only to the argument that unemployment is structural, rather than general, in that it is concentrated in certain areas of unskilled workers, as pointed out by Federal Reserve Board Chairman William McChesney Martin in testimony several weeks ago before the Joint Economic Committee. Beyond this, the failure of the rate of unemployment to decline appreciably in the face of an increase in the number of employed suggests that to some extent we may be getting an artificial picture of the rate of unemployment. It may be, for example, that when the head of a household loses his job, another member of his family not hitherto in the labor force seeks employment and the enumerators then count both as unemployed.

Speeded growth and full employment may be clues to more inflation

I would say, therefore, that there are good grounds for being skeptical about the argument that chronic slack will afford assurance against the resurgence of inflationary pressures in the next period of business expansion.

A very important reason for believing that inflationary pressures may reappear in the next few years is the great emphasis which is being placed by the Federal Government on pursuing the objectives of full employment and faster economic growth. We all applaud these objectives provided that they are linked with the goal of general price stability.

I do not mean to suggest that stability of the general price level is inconsistent with the pursuit of full employment and vigorous economic growth. Rather, I strongly believe that general price stability is absolutely essential to sound and sustainable economic growth. The point is that under conditions of full employment and accelerated growth the job of maintaining general price stability becomes exceedingly difficult and requires more timely and better informed government and private policy actions than we have had in the past.

On one hand, the important reasons for believing that further inflation is not in prospect in the early 1960s, and on the other, some equally important reasons why inflationary pressures may reappear in the next few years. Against the background of this discussion, my own conclusions on whether inflation or deflation lies ahead are:

▶ We can rule out the possibility of any significant and prolonged decline in the general price level in the early 1960s. This is based on the conviction that the currently popular theory of chronic slack will prove to be a total myth, and that the aggregate spending by consumers, business and industry, and all levels of government in the emerging space age, and under continuing conditions of international political tension, will be so great as to assure no real possibility of general deflation. I am tempted to say that with the huge volume of private and public debt which has been built up during the past 15 years any significant general deflation would be politically inconceivable.

▶ I believe that the danger of renewed inflationary pressures in the early 1960's is a real one which must be vigilantly guarded against. The natural forces of general business recovery now beginning to show themselves, plus government, fiscal, monetary, housing, and other policies aimed at achieving full employment and faster economic growth, could easily revive the forces of inflation by the second half of 1962. It is significant that inflationary booms are usually traceable to such factors as large Federal deficits and excessive liquidity resulting from policies adopted in business recession but delayed in their impact until the boom phase of the cycle. So far we have seemed to avoid this danger of being too heavy-handed in the recession, thanks to the limitations placed upon expansionary policies by the international balance of payments and gold outflow problem, but it remains to be seen whether we shall continue to have such admirable restraint.

▶ Although I believe the forces of inflation will not be far below the surface in the next few years, I would guess that any rise in the general price level that may occur will be moderate. This opinion is based on the

(Continued on page 20, column 3)

THE PECULIARITIES AND THE CONFLICTS IN VARIOUS STATE LAWS AFFECTING THE PURCHASE OF MORTGAGES BY INVESTORS

ONE of the first requirements of the out-of-state lender, and the mortgage banker making real estate loans, is an understanding of the laws by which such loans will be governed. There are many peculiarities and conflicts in the laws of certain states with their concomitant expenses, risks or uncertainties. Being aware of them can avoid unpleasant surprises.

A few examples illustrate some of these laws. A lender usually takes particular care that his mortgage shall be a valid first lien of record, except where taxes not yet due may enjoy a priority under state law. However, in a few states mechanics and materialmen may acquire liens as to improvements made that are prior even to a previously recorded mortgage (Alabama, Alaska, Missouri, Montana, Oregon). Again, a mortgagee should have in mind foreclosure procedures and costs that may follow financial difficulties of the borrower. Several states afford borrowers long redemption periods (Alabama and Tennessee, two years; Kansas, 18 months) and foreclosure process is sufficiently difficult to be quite expensive for attorneys' fees and costs. On a $10,000 loan in the Chicago area, these can total approximately $1,300; in Oregon and Puerto Rico, $500; in the State of Washington, $550. Regarding a deficiency judgment following foreclosure, none is obtainable in California if the mortgage or trust deed was for purchase money and only with the court's permission in a mortgage foreclosure in Nebraska.

In the District of Columbia the maximum interest rate that may be charged in a real estate loan is 8 per cent. However, its so-called "Loan Shark Law" makes it illegal to engage in the business of lending money in excess of 6 per cent without first procuring a license as a money lender. This law excepts from such requirement national banks, licensed bankers, trust companies, savings banks, building and loan associations and real estate brokers. It does not except other lenders, including life companies who may not, therefore, make loans at over 6 per cent without obtaining such license. In Oklahoma, on recording a mortgage for five years or more, the registration tax, 10 cents for each $100 or fraction of the mortgage, must be paid by the mortgagee. Any scheme, arrangement, inducement or device which charges to or exacts from the mortgagor the payment of such tax is a misdemeanor, the state's statute says. In a $1,000,000 loan the

tax would be $1,000.

Set forth below are the foregoing and other unusual laws:

Alabama: Mechanics' and materialmens' liens as to improvements are prior to a mortgage of record. The state's redemption period following foreclosure is two years.

Alaska: Mechanics' and materialmens' liens are "preferred to all other liens, mortgages or other incumbrances upon the land upon which the building or other improvement shall have been constructed or situated when altered or repaired."

Arkansas: Every instrument by which title to real estate or personal property, or any interest therein, or lien thereon, is conveyed, created, encumbered or otherwise, may not be recorded or filed unless the name of the person and his address is shown on the first page thereof.

California: A mortgagee may not obtain a deficiency following foreclosure of a purchase money trust deed. The court said regarding the statute in this regard: "One taking purchase money trust deeds knows the value of his security and assumes the risk that it may become inadequate, especially where he takes a second purchase money trust deed, and he is precluded by Code of C. P., sec. 580b from bringing action on the note after the security has become valueless because of sale of the security under the first purchase money deed."

District of Columbia: A life company may not charge more than 6 per cent interest on mortgage loans in this state unless it procures a license as a money lender under the "Loan Shark" law. The maximum rate in the District of Columbia is 8 per cent. The "Loan Shark" law excepts from this license requirement national banks, licensed bankers, trust companies, savings banks, building and loan associations and real estate brokers. Life companies, however, were not excepted.

Florida: Under a recent Florida law, any mortgage in which the final payment or the balance payable on maturity is greater than twice the amount of the regular monthly or periodic payments thereunder is designated a "balloon" mortgage. Such a mortgage must have printed or stamped on its first page above the signature of the mortgagor the words: "This is a BALLOON Mortgage and the Final Payment or Balance due upon maturity is $———." If this is not complied with the mortgagor may continue to make payments at regular rate until paid. The act does not apply, however, to first mortgages or those for more than five years or to any mortgage in effect prior to January 1, 1960.

Illinois: Foreclosure is by court action with difficulties such that approximate expenses in Chicago are as follows:

$10,000 loan—$800 attorney's fee—$465 costs
$15,000 loan—$1100 attorney's fee—$540 costs
$20,000 loan—$1400 attorney's fee—$615 costs
$25,000 loan—$1700 attorney's fee—$750 costs

Indiana: 1. The limitation period to foreclose a mortgage is 20 years under sec. 2-623, Burns Ind. Stat. Anno. and "within 10 years" under sec. 2-602. These being in conflict, the mortgagee should be governed by the "within 10 years" statute.

2. Chattel and real estate mortgages in this state must disclose name of person who drafted the instrument.

Kansas: In foreclosure in this state, the mortgagor is allowed an 18 month redemption period during which time he is entitled to possession and the rents. However, this may be reduced to six months in purchase money mortgages and a corporation may waive redemption in this state.

Massachusetts: The scope of the ½ per cent tax in Massachusetts on savings banks and trust companies having savings departments is set forth in Mass. General Laws, Chap. 63, sec. 11, originally enacted in 1862 to help finance expenses of the Civil War. The tax is based on the amount of the savings bank's or trust company's deposits, such amounts as have been received by depositors. It is in the nature of an excise or duty on the rights granted by the Commonwealth for the use, exercise and enjoyment of corporate privileges. This tax is avoided if such deposits are invested

In speeches over the country this year, President Tharpe has often commented on the antiquated state laws under which mortgage investment is done

What we need, what we must have eventually, is a broad effort in this area to modernize state laws which exert such a detrimental influence

And, however we estimate the way the job should be done, it adds up to the conclusion that a mammoth undertaking is ahead

What Mr. Sherman says here points to the conflicts in state laws, to variations which make mortgage lending far more complex than it should be

By MALCOLM C. SHERMAN

in loans secured by real estate taxable in Massachusetts (Chap. 63, sec. 12(b)). Investments from deposits in out-of-state mortgages are taxable at ½ per cent, but if such investments, added to such other "taxable" investments as corporate bonds, bank stocks, banking house, etc., are from and do not exceed reserves, profit and loss or guaranty funds, they are not subject to such tax. Many banks, particularly the smaller country banks, "ride the tax point" by deliberate limitation of taxable instruments. The larger city banks are generally well past the "tax point" and thus view all out-of-state mortgages as taxable at ½ per cent.

Missouri and Montana: Mechanics and materialmen have lien on improvements for work done superior to prior liens on the land.

Nebraska: A deficiency judgment in foreclosure may not be obtained except with permission of court in a separate action.

Ohio: 1. Mortgagee's situation in Ohio on death of mortgagor: On death of mortgagor where mortgage is not in default and not due, in most states when the mortgagee makes no claim within the time allowed by statute against the estate the personal obligation of the estate is lost but the security remains unaffected. In Ohio, however, the note secured by the mortgage may be paid with interest to date of payment by the executor or administrator and shall be so paid on demand of the creditor. If the creditor refuses to accept payment, the executor or administrator sets aside assets to satisfy the claim and the sufficiency of such assets must be first approved by the probate judge. If thereafter such assets become insufficient to pay the claim in full because of depreciation or loss without fault of the executor or administrator, neither of them nor the remaining assets of the estate are liable to the creditor (sec. 2117.28). When the only debts of an estate remaining unpaid are secured by liens on real estate, the devisees, legatees or heirs entitled to receive the property may take it subject to such liens, if lienholders consent and waive recourse against other assets of the estate in the event the property is insufficient to pay debts secured by such liens (sec. 2117.29). In practice, on the death of an obligor on a note secured by mortgage the mortgagee is going to be asked to release the estate. It is to the mortgagee's interest to so do under Ohio law, if the security is adequate.

2. Chattel and real estate mortgages in this state must disclose name of person who drafted the instrument.

Oklahoma: 1. An effective assignment of rents as additional security to a mortgage is not obtainable in this state.

2. On recording a mortgage, the mortgagee must pay the registration tax—10c for each $100 or fraction if mortgage is 5 years or more; 8c if for 4 years; 6c if for 3 years; 4c for two years and 2c if less than 2 years. This expense may not be charged to the mortgagor. To attempt so to do is a misdemeanor.

Oregon: Costs of foreclosure are high. $500 to foreclose a $10,000 loan. Mechanics and materialmen enjoy a priority as to improvements even over a recorded mortgage.

Puerto Rico: Foreclosure is by court action. Costs in a $10,000 loan: approximately $500.

Tennessee: 1. Borrower has a two year redemption following a foreclosure sale.

2. A note usurious on its face is void.

Utah: Under L. 1961, S. 193, approved March 13, 1961, effective May 9, 1961, after July 1, 1961 releases or assignments of mortgages, deeds of trust, leases or other documents creating a lien on real property must contain a legal description of the real property affected to entitle them for record. This will require special care in drafting instruments affected by this act.

Virginia: Under sec. 6-351 of the Virginia Code, 1950, as amended, a corporation may not plead usury. However, sec. 6-352 provides that "nothing in the act of incorporation of any insurance, banking or other corporation shall be construed as giving authority (unless expressly given) to charge, take, or receive for the loan forebearance of money or other thing, more than the legal rate of interest." From the two statutes it is not clear whether or not a corporation may plead usury in Virginia.

Wisconsin: No instrument by which title to real estate or any interest therein or lien thereon, is conveyed, created, encumbered, assigned or otherwise disposed of, shall be recorded by the register of deeds unless the name of the person who, or governmental agency which, drafted such instrument is printed, typewritten, stamped or written thereon in a legible manner. This form complies with this section: "This instrument was drafted by —(name)—." This section does not apply to an instrument executed before May 9, 1957, nor to a decree, order, judgment or writ of any court, a will or death certificate, nor an instrument executed or acknowledged outside of Wisconsin (sec. 59.513).

Washington: Foreclosure is by court action. Approximate cost of $10,000 loan foreclosure: $550.

INFLATION? DEFLATION?

(From page 17)

thought that although government policies will be expansionary, they will be limited by the need to meet the discipline of foreign competition. Thus, as I see things, there is little danger of a sharp run-up of the general price level, but there is a danger of the government pursuing expansionary fiscal and monetary policies to the point of provoking a moderate decline in the value of the dollar, say 2 per cent per year. Indeed, there are many economists today who argue that this degree of inflation is justified, if not required, to permit the achieving of full employment and faster growth.

▶ Whether the maintenance of full employment and faster economic growth can be achieved without provoking further inflation depends in large measure on the means employed to achieve these goals. If they are pursued by means of government policies designed to encourage a higher rate of personal and business saving, and a higher rate of private investment spending, and if such policies are accompanied by appropriate monetary policy, I think that there is a good chance to accomplish full employment and a somewhat higher growth rate on a sound, sustainable basis without incurring further inflation.

▶ Finally, the steady rise in the cost of services even in business recessions suggests that, regardless of the movement of the general price level, the services will probably remain a troublesome area of steady price rise in the early 1960's.

As before Economic Conference of National Industrial Conference Board.

President's Page

THE CONVENTIONAL LOAN IN MORTGAGE INVESTMENT

OVER the last two years, the Mortgage Finance Committee of the American Bankers Association has been studying means for making the conventional home mortgage a more effective instrument in the national mortgage market. Having reached the point where it has definite proposals to suggest, the ABA is creating an advisory committee to review the research and the conclusions.

The advisory committee is to be broadly representative of groups in addition to its own which are concerned with home mortgage finance—life insurance companies, mutual savings banks, mortgage companies, savings and loan associations, and home builders. Carton Stallard, Dale Thompson and I have agreed to serve on behalf of the Mortgage Bankers Association of America.

Robert Tharpe

The ABA is to be congratulated on this move. Not only is it generously making its research available to the entire home mortgage lending industry, but it has also given assurance that it wishes any program that it may sponsor to be acceptable to the other elements of the industry and to be of benefit to all of them as well as to the home buying public.

The ABA's research has been based on two premises: (1) that means must exist for maintaining a national market for home mortgages, and (2) that, under present trend to special purpose and social welfare functions (as contrasted with broad market functions), the FHA may be gravely hampered as the means for maintaining such a national market.

I certainly have no quarrel with the first of these premises and I am reluctantly coming to the conclusion that the second is also true. The disruption that the FHA has suffered this year from unwisely administered interest rates, withheld funds for administrative purposes, consequent delays in processing, and distraction by a host of complex and relatively unproductive operations, is at least a warning that the premise may be correct.

While the policy of this Association has always been to strengthen FHA by adherence to its original principles and independence; and while we need not yet, I hope, give up all expectancy of the ultimate achievement of these objectives, we should not ignore the possible—and even the probable—need for alternatives.

The formation of the ABA committee gives the industry just this opportunity. It also provides the opportunity for the discussion of other proposals for improvement of the home mortgage market that are now current, notably those developed in the study of secondary market problems that has been conducted by the University of California at Los Angeles and by the Commission on Money and Credit that was sponsored by the Committee for Economic Development.

Perhaps the most important opportunity offered by the formation of the ABA Committee is the facility that it provides for an interchange of thought and point of view among the different types of institutions in this varied, fascinating, and vital industry—all with the objective of broadening its service to the country's home buyers and builders. With all this material before it and with additional ideas that may come from the discussions, the new committee should be able to come up with some practical solutions of our problems.

Again we may thank Cowles Andrus, the Chairman of the ABA Mortgage Finance Committee, Kurt Flexner, its director, and the other members, for the significant step they have taken.

Robt. Tharpe

PRESIDENT

No Funeral Y

THE FUTURE investment status of FHA mortgages has been persuasively challenged by Dr. James O'Leary in an article in *The Mortgage Banker**. I am sure no one will mind, and many may welcome, a few words of refutation presented in the friendliest spirit. The FHA loan has become so important to so many mortgage bankers, that it should not be shot down, even verbally, without a spirited defense. Nor should the vital interest of the home-buying public be overlooked.

In my reading of the article, *Is The FHA Loan Facing A Decline?*, I found it interesting to place marks in the margin at points where a stated fact or circumstance, followed by a conclusion, evoked in my mind an opposite conclusion. There were quite a number of these. The first such point names FHA as a depression-born device designed to bring wary lenders back to the residential mortgage field for the benefit of the home-buying American public. It is stated that the investment climate and, inferentially, the economic and political climates, have so changed since those days that the FHA loan is likely to lose its governmental, public, and investment support.

This viewpoint is rather quickly countered, it seems to me, by the signs of the speedy ride we are taking toward more government paternalism, the increased pushing of socialistic measures in every field, including housing, and the shining-eyed, happy way in which our senators and representatives have latched on to the housing industry as one of the best political merry-go-rounds of all time. Under its umbrella they can play never-ending music to builders, homeowners, veterans and even lenders.

In this atmosphere, is FHA likely to be killed?

The next point is the swing of institutional lenders toward conventional loans and away from FHA loans. My opinion is that this is simply inaccurate, and particularly inaccurate as to residential loans. My firm is an old one and is active in every phase of mortgage lending. We are the mortgage loan correspondent for 24 institutional lenders, about equally divided between major life insurance companies, mutual savings banks and pension trusts. Those of them which have changed their residential lending policies in recent years have pretty well shut down their conventional home loan programs and moved strongly into FHA and VA loans. If Dr. O'Leary had pointed up the fact that numbers of insurance companies (mainly) are currently pushing more strongly into *large* conventional loans on *commercial* and *industrial* types of security, he would to that extent have been correct. Speaking of the institutional lenders who obtain the bulk of their mortgages through the mortgage loan correspondent system, the change, as I see it, is their trend toward six and seven-figure commercial loans, and toward *FHA and VA* loans which can be bought in large blocks.

Further comment is made about corporate and industrial pension funds, which are reported not to have gone

*June 1961.

l Yet for the FHA Loan

A mortgage banker contends the insured mortgage does not face a less important role — is he right?

In the June issue, Dr. James J. O'Leary asked the question Is the FHA Loan Facing a Decline? and set forth his reasons for thinking that it is—also citing his ideas as to what it will take to halt the decline. Not all mortgage bankers see it that way and these comments by one of them are in the nature of a rebuttal to the O'Leary thesis

to any extent into the FHA market. A more complete statement, as to this, would be to point out that statistically or percentage-wise they have barely dipped into the mortgage field at all. However, in starting mortgage programs at the request of pension trusts, the experience of my firm, and the experience of a number of others with which I am familiar, has been that the pension groups want FHA and VA residential loans, *in every case.* Unfamiliar with mortgages but liking their high yield, these people must make a wrenching turn away from precedent and tradition—the purchase of government bonds and other low-yielding, ultra-conservative issues — and they draw comfort and relief from the government-backed mortgage insurance feature of the FHA loan.

Later in tentative and hesitating fashion, a few of them look at conventional loans. Not many pension funds, however, are physically or mentally geared to analyze, pass on, and purchase conventional loans. Cumbersome finance committees, made up of people unfamiliar with mortgages in general, rarely meeting more often than monthly, are neither equipped nor inclined to handle conventional loan submissions. On the other hand, purchases of blocks of FHA or VA loans from the on-the-shelf inventories of their mortgage originators fit in very well with the pension fund organizational set-up. Conventional loans are rarely carried in inventory by mortgage originators. I think there is a distinct possibility that pension funds, corporate, industrial, union and municipal, may in time become the biggest takers of FHA loans. And, contrary to the opinion expressed in the article under discussion, these are the very kinds of institutions whose rate of growth is the greatest.

The theory is advanced that insurance companies will become more interested in types of mortgage investments other than FHA loans, meaning conventional loans, on which they can obtain higher investment yields. Now, net yields from conventional as compared to FHA loans are by no means in a state of fixity. Their relative positions can and do fluctuate, as discounts change on insured loans, and interest rates move on conventional loans. The basic premise, therefore, does not seem a valid one.

Further on the point of institutional investment trends toward FHA loans, I note with much interest that the prospectus for the first large new real estate investment trust to get off the ground states plainly that the bulk of its funds will go into FHA and VA loans. This could become the pattern also for others that will follow. In any event, it is already evident that insured loans are sure to play an important part in the investments of this burgeoning new type of institution.

Another point made in the article is that the FHA loan was conceived and

By PAUL H. HOWE
Vice President, The Marble Company, Pasadena

did a good job for financing families whose income and economic position indicated they could well carry the monthly payments, but now we have taken care of most of these people, and have remaining mainly the housing needs of low and medium-income families for whom the FHA program is stated to be not well adapted. This point goes counter to every tenet of the FHA system, whose down payment schedule and entire structure heavily favor the lower-priced homes and their buyers. It ignores also the patterns set in the 1961 housing bill, further lengthening the term of FHA loans, and once more liberalizing (lowering) down payments. Neither to be forgotten is the political mileage that congressmen get out of pushing these generous insured-loan programs, and I see no likelihood of change. Dr. O'Leary himself mentions this in speaking of the FHA and FNMA programs as being used to accomplish welfare objectives, and so seems to contradict statements made elsewhere in his paper.

While it may well be that lenders cringe and complain about each new wave of liberalization in FHA loan terms, and resent their conflict with normal concepts of sound lending, our history since 1934 has shown that they regularly string along and make these loans, with eyes sharply focused on the government-backed insurance feature.

I doubt the ultimate degeneration of FHA loans into a program of direct government lending on a large scale. Such a contest of the open-end public purse versus a well-respected private lending system under government aegis presents, fortunately, so clear-cut an issue that it is certain to be the subject of a mighty battle, long-fought and likely of defeat.

The concluding recommendations are excellent, but so removed from possible accomplishment that I see little hope for them. A snowball rolling downhill does not reverse its direction and go up again. Lifting of the ceiling on the FHA interest rate has been clobbered in the halls of the Congress every time the subject arises. Now, policy of the present Administration is clearly to press interest rates *down*. It may not work, or go much farther, but the statutory rate of government-insured loans is hardly apt to go *above* where it was when President Kennedy took office. So, the discount system will continue to have to do the job of determining the true yield to lenders who buy FHA mortgages, and it will do so. But this does not mean the FHA loan is dying. No funeral oration is in order. Lenders need these loans. No others can be so easily bought *en bloc*, so readily resold in an ever-present market, or carry a government bail-out if something goes wrong.

The idea of legislative action to inject greater risk and underwriting responsibility into FHA loans contravenes both the government aim to reduce risk and so increase attractiveness, and the implied push toward lenders' acceptance of the government insurance as a substitute for risk-taking and tight underwriting. Lenders who wish to be completely responsible for judging and underwriting their risks are unlikely to do so within the framework of any slow-moving, paper-laden insured loan system, sponsored by the government, either as at present, or modified to incorporate more risk and responsibility. Those who want conventional loans can get them quickly and under their own rules; those who, for the reasons mentioned above, like FHA loans, understand the attendant rigmarole and will put up with it because of the system's other advantages.

Incidentally, it should not be assumed that lenders do not underwrite FHA loans. Far from it. Nearly all do, and most will vehemently deny that they accept any FHA loan simply because it has been underwritten and approved by the Federal Housing Administration.

I cannot see that the suggested step of federal action to bring about uniformity of (a) interest paid on deposits and (b) maximum mortgage limits, as between the various classes of lending institutions, is germane to the subject of the article. In their FHA loan programs, every class of lender is free to make loans at FHA's maximum limits, and so all are equal. There are not the distinctions found in conventional residential loans, with various laws limiting banks, for example, to 60 per cent or 65 per cent loans, insurance companies to 75 per cent, savings and loan associations to 80 per cent, etc. So, the recommended correction describes a condition which already prevails.

And as to uniform patterns for interest paid on deposits, should commercial banks and savings and loan associations, dissimilar as they are, pay the same rates? Are insurance companies, deriving their funds from sales of life insurance, to be tied in on an equivalent basis? Can this be done? Is it practical? Fair? How about mutual savings banks vis-a-vis pension trusts? This writer can only suggest that we not let ourselves be carried away.

(Continued on page 44)

What Would Happen to FHA in an Urban Affairs and Housing Department?

The plan to set up a new Department of Urban Affairs and Housing with cabinet rank has been an objective of the present Administration and there has been a great deal of discussion, as well as hearings in Congress, as to whether the move would be a good or bad thing for FHA. MBA takes the view that it would be the latter and has vigorously opposed the plan. What follows is a transcript of the statement which Jack Adair of Atlanta, chairman of MBA's Legislative Committee, made before members of the Senate Committee on Government Operations setting forth the reasons why under such a program FHA could well become something considerably different than it is today. Sub-committees of the Government Operations Committee in both chambers have completed hearings but it is not expected that congress will act this session. Reason: too many more pressing matters, but look for the proposal in the next session

The Mortgage Bankers Association of America has long held the view that the Federal Housing Administration's system of mortgage insurance is an essential means for encouraging the flow of funds across state lines, for attracting funds from areas of capital surplus to areas of capital shortage, and for diminishing regional differences in interest rates—thus creating a national market for home mortgages. This, the Association considers to be the primary and, so far, the irreplaceable function of FHA; and the policies of the Association have been directed to the maintenance and improvement of the FHA system to this end.

Since the recognition of sound credit principles is vital to the successful operation of a system of mutual mortgage insurance, the Association has considered it wise to keep as distinct as possible a separation of the self-supporting mortgage insurance operation from governmental functions that involve other than strictly market activities, such as direct lending and subsidy. In pursuit of this objective the Association has frequently urged that the Federal Housing Administration be restored to its original independent status in the structure of the federal government.

Notwithstanding this position, when the present administration indicated its desire to create a new executive department encompassing the mortgage insurance operation and various other operations related to urban life, the Board of Governors of the Association approved the following resolution:

"MBA believes housing deserves greater emphasis than it has had heretofore, especially in the field of slum clearance and rehabilitation in our cities. Greater cooperation among all agencies in the accomplishment of this worthy objective is required. Care must be taken to recognize the differences between the essentials of a healthy private credit system assisted by Federal programs and the criteria necessarily involved in direct Government loan and grant programs commonly known as welfare programs. Thus, the administration of programs designed to assist private credit should be kept separate from those designed to accomplish welfare purposes.

"If the above principles are recognized, and if it can be shown by a new Administration that they, plus other desired programs, could better be accomplished by giving Cabinet status to a Housing Agency, we would recommend that MBA not oppose such status."

After careful consideration of the pending bill, S. 1633, the Association is forced to conclude that the bill's provisions do not conform to the stipulation in the resolution. Housing—that is, private housing—is definitely given a secondary role both in the statement of policy and in the organization of the proposed department. In the policy statement, for example, there is not even an allusion to private enterprise—which is quite in contrast to the original statement of housing policy as set forth in the Housing Act of 1949.

The proposed legislation does not simply transfer the Federal Housing Administration with all its functions intact to the new department. It abolishes FHA and transfers its powers and functions to the new secretary, subject to any future redistribution he may care to make.

In this we see support of what the policy preamble implies: a sharp shift

in emphasis from the free operation of the private market to a centrally directed development program to which private building and private investment are incidental except as they may serve the general plan.

What might happen in future poses a real threat for FHA

While we accept the statements of the present housing officials that they do not intend to diminish the emphasis on the private sector, we recognize also that they will not always be in office. The primary interest of a future secretary may be in other directions. In fact, with the legislative authority in his hands and with the mandate of the policy statement before him, it seems inevitable that a future secretary will feel called upon to divert FHA from its original and basic purpose of broadening and strengthening the whole private home mortgage market to that of serving a more restricted and specialized purpose.

Mortgage credit itself is a specialized form of activity and requires for its effective administration experience and attitudes that are quite different from those needed for the conduct of direct loan and grant operations. The present arrangement, under which the FHA Commissioner has a considerable degree of independent legal authority, makes it possible to meet this requirement. With all authority blended in one official, as this bill calls for, there would be much less assurance of the understanding of, and adherence to, sound credit principles that have created the longstanding confidence in FHA as an institution.

From the title of the bill on, this legislation puts the cart before the horse. Private housing and private mortgage credit are not secondary to the kinds of "urban affairs" mentioned in the legislation. They are more than an instrument of urban renewal and the other functions to be included in the new department. Private housing and mortgage credit are at the basis of community development. Other activities should be designed to serve them, rather than the reverse.

The problem in the development of a strong home mortgage credit structure does not arise out of any need for the amalgamation of self-supporting private credit functions with a mass of direct governmental operations, but rather from a need for better coordination among the private credit activities with which the government has concerned itself—FHA, FNMA, the loan guaranty program of the Veterans Administration, the Federal Home Loan Bank System and, perhaps in prospect, a federal system of mutual savings banks. The questions of policy and operation that arise among these agencies are far more serious than those that arise between FHA and an occasional urban renewal operation, and they directly affect far more of our people and our institutions than do the other activities included in the proposed new department.

Separation of FHA and FNMA will curtail role of each

Any plan that does not encompass all these market-oriented agencies and their functions cannot claim to accomplish what this legislation is supposed to do. Moreover, any plan which further separates FHA and FNMA from those other mortgage credit agencies and from the private credit structure generally, cannot help but diminish the future role of these two important institutions as features of the private mortgage system.

Serious attention should be given to this probability, because, over the years, FHA mortgage insurance has become an integral part of the nation's private residential mortgage system. It has greatly increased the volume and diversity of the private funds that flow into the mortgage market; it has facilitated the expansion of home ownership; it has encouraged private investment in rental accommodations; it has fostered the growth of an efficient, responsible home building industry.

Because of the wisdom of the original statute, the able leadership exhibited by its successive administrators, the sound business principle under which its operations have been carried on, and the obvious improvements that it has accomplished in housing conditions and in building and lending practices, a unique relationship of confidence and interdependence has been established between the FHA and the home building and home financing community.

The mortgage companies and the investing institutions comprising this Association have been the principal participants in the national mortgage market that FHA has made possible. Consequently the Association has a genuine concern with any proposal that may in any way disrupt the relationship that has made such a beneficial contribution to the social and economic well-being of the country. The proposal to "abolish" the FHA thus has an ominous ring. Not only does it threaten the well established and compatible relationship between government and private activity, but it also raises questions about the continuity of policy and the status of the numerous and vital contractual arrangements in which the FHA operation is involved. The proposed legislation raises these questions. It answers none of them. As the world's largest business insurance operation, the FHA deserves more thoughtful consideration than this.

These are the actions we would recommend be taken

In order for the pending proposal to remove the doubts it has caused, to assure the continuance of a successful working relationship between government and the private mortgage lending institutions of the country, and to advance rather than retard the development of an effective home mortgage credit system, several changes are essential.

1. The policy preamble should be rewritten so as to state unequivocally the predominant dependence to be placed upon private building and private lending activities, the encouragement to be given to the improved functioning of the private home mortgage credit system, and the faith to be maintained in the effectiveness of a private market economy.
2. The powers of the Federal Housing Commissioner and the administrative organization of the Federal Housing Administration should be kept intact.
3. The new department should encompass for coordinating purposes, in addition to the agencies and

(Continued on page 38)

Tax Treatment of Pre-1960 Acquisitions and Sales of FNMA STOCK

Second in a series of articles on tax matters affecting mortgage bankers

By H. CECIL KILPATRICK

THE FEDERAL National Mortgage Association was created by an Act of Congress. Its capitalization is somewhat unique. It has one preferred stockholder, the Secretary of the Treasury. Its common stock is initially issued only to sellers of mortgages which FNMA is authorized to purchase. If a mortgage company sells to FNMA, it is required to take FNMA's common stock at par ($100 per share) to the extent of a percentage[1] of the principal balance due under the mortgage at the date of sale, regardless of the market value. The Act treats the form of this transaction as "payments of non-refundable capital contributions" by the seller of the mortgage, and issuance to such seller of common stock at par to the extent of such "contribution." However, the Act is clear that this "contribution" is required.

While there is a public (over the counter) market for FNMA stock, it has fluctuated from a low of 39 to a high of 81. Present quotations on the stock are 74½ bid and 76½ asked.

In this article, we shall consider the case of the mortgage company which sells to FNMA a mortgage with a principal unpaid balance of $10,000. We shall assume that the mortgage company has only $9,700 invested in the mortgage, having originated it at a discount. FNMA pays the mortgage company $9,600 in cash for the mortgage, plus FNMA stock of a par value of $200, but a market value (for our purposes) of only $100. The *value* of what the mortgage company receives is therefore $9,700. The mortgage company does not want the stock, takes it only because it is a necessary requirement, and promptly sells it for $100.

1. Formerly 3%, presently 1% to 2% as fixed by FNMA; usually 2%.

The questions to be discussed are the tax effects of (a) the sale of the mortgage, and (b) the subsequent sale of the stock. These questions are answered by affirmative Internal Revenue Code provisions[3] *for taxable years beginning after December 31, 1959.* The substance of these new provisions is this:

(a) The excess of par over market value of the stock when issued to the seller of the mortgage is deductible as an ordinary business expense of the year (which simply means that in computing gain or loss on sale of the mortgage, FNMA stock is taken into account only to the extent of its fair market value); and

(b) The tax "cost" of the FNMA stock is its par value minus the amount so deducted.

In the case we are considering, if the sale of the mortgage occurred during a taxable year beginning after December 31, 1959, the seller would realize no gain or loss on either the sale of the mortgage or the sale of the stock.

The position of the Internal Revenue Service appeared first in 1958 in a published ruling[4]. While conceding that, in acquiring FNMA stock, "investing may not be [the] primary motive" of the seller of the mortgage, the Service nevertheless treats the sale of the mortgage and the purchase of the stock as they would be treated if they were independent and unrelated transactions. In the typical case we are considering, therefore, the Service says our mortgage company sold the mortgage for $9,800 in cash, resulting in a profit of $100; that it then invested $200 in the stock, which represents a capital asset; and that, when that capital asset was sold for $100, there was a capital loss which could not be deducted from ordinary income, but could only be offset against capital gains, if any[5].

3. Section 8, Pub. Law 86-779, 86th Cong., 2d Sess.
4. Rev. Rul. 58-41, 1958-1 Cumulative Bulletin, p. 86.

In reporting favorably the 1960 Tax Code amendment which was subsequently enacted (see footnote 3), the Ways and Means Committee stated:[6]

"In making this statutory amendment, however, your Committee intends no inferences to be drawn as to the tax treatment accorded FNMA stock before the enactment of this provision."

It seems reasonably clear, therefore, that the new legislation has no bearing on pre-1960 taxable years, and the question for any such year is to be decided as though the new provisions had not been adopted.

Although the Government has lost the only court case decided to date on these issues[7], it has adhered to the position taken in its published ruling, and a number of disputes are now pending, both in the courts and in the Internal Revenue Service. One case, now under consideration by the Tax Court, may be decided before the publication of this article. To the average citizen, it may seem odd that, having submitted its position to a court test and lost, the Internal Revenue Service is

5. Sec. 1211(a), Internal Revenue Code of 1954.
6. House Rep. No. 1662, 86th Cong., 2d Sess.
7. *Schumacker Mortgage Co. v. U. S.*, U. S. District Court, West. Dist. of Tenn., May 23, 1960, 60-2 USTC par. 9524; not appealed because of other issues in the case.

adhering to this repudiated position, as a matter of policy. However, this is not novel. The Service has often pursued an issue, after a loss in one or more courts, in other jurisdictions, hoping that it may get a conflicting decision elsewhere and thus have grounds to ask the Supreme Court to intervene and resolve the conflict in the lower courts. Sometimes, if it loses in two or three of the Federal Appellate Courts, the Service will acquiesce. No assurance can be given any mortgage company, at this time, that the same points will not be raised on examination of its returns, and there is nothing the industry can do presently in avoiding a controversy of this type. Suggestions that the Association attempt, through the administrative ruling procedure, to get the Service to retreat from its position are unrealistic. The Service will not, while deliberately fighting a battle in court, admit defeat by publicly conceding the unsoundness of its position. While it is to be hoped that if the Tax Court, in the case pending before it, reaches an equivalent result to that in the *Schumacher* case, the Internal Revenue Service will retreat and follow these decisions, this cannot be predicted with any degree of confidence. This article, therefore, will merely attempt an analysis of the issues and a presentation of the views which the writer believes the courts should adopt.

If, as the Internal Revenue Service insists, we are to look only at the form of the transactions under consideration, there are some precedents which may be cited as supporting the Service's position. The Government's primary reliance seems to be upon a case[8] (the only case cited in the published ruling as a justification for the Service's position) where, in order to obtain a concession at the New York World's Fair, the taxpayer was required to purchase debenture bonds sold to finance the Fair. After holding the bonds two years, the taxpayer sold them at a loss, and claimed that loss as a business deduction. The Court held this to be a loss from the sale of a capital asset. That case may be distinguished from the one we are considering on several grounds. In the first place, the market value of the bonds at date of purchase was not proved; second, this was treated by the taxpayer in its books as an investment and held as such for two years, during which interest payments received were reported as investment income, and partial payments on principal were treated as reduction in basis of a capital asset; and, last, this was an isolated transaction, not a normal or ordinary incident to carrying on the taxpayer's business. The Tax Court found as a fact, therefore, that the debentures were not held for sale in the ordinary course of business.

Even if form were to take precedence over substance, and the sale of the mortgage treated as unrelated to the purchase of FNMA stock, one other question would need answering: Was the FNMA stock a "capital asset"? The statutory definition of a capital asset[9] excludes:

"(1) stock in trade * * * or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

Under normal and almost universal practice, the mortgage company not only does not want to acquire FNMA stock as an investment, but intends from the beginning to dispose of that stock as soon as is economically feasible. In deciding whether property is a capital asset or is property held primarily for sale, the courts have adopted certain criteria, the most important of which is this: If the taxpayer's purchases and sales are frequent and continuous, the sales do not result in capital gain or loss and the taxpayer will usually be held to have realized ordinary income or loss from the sales[10]. By the same reasoning, the mortgage company which has frequently and continuously over the years sold mortgages to FNMA and has consistently sold within a brief period the stock received in such a transaction, might well be said to hold such stock primarily for sale in the ordinary course of its business, and to be entitled to deduct the loss on sale as an ordinary loss if required to treat par value as its "cost" of the stock. This would make the *Exposition Souvenir* case (see note 8) inapplicable, whether or not the approach be to exalt form over substance.

▶ *Looking Through Form to Substance;* (a) *Generally*—Volumes have been written on the subject of whether substance should prevail over form in determining the tax consequences of transactions. For present purposes, we need look only at some of the cases which have treated what is, in form, a purchase as, in substance, something else. In contrast to the *Exposition Souvenir* case discussed above, we find the following:

(a) Where a wholesale liquor dealer, when liquor was in short supply, bought stock of a distilling company because the latter gave its stockholders a right to buy liquor at the distiller's cost, exercised its rights as stockholder and got the liquor, and then sold the distilling stock at a loss, the loss was treated for tax purposes as a part of the cost of the liquor[11].

(b) Where a manufacturer of machinery which was required, as a condition of getting a contract with a foreign government, to deposit U. S. bonds as security for performance, bought and deposited such bonds, and later sold them at a loss, both the Tax Court and the Court of Appeals for the Second Circuit agreed with the taxpayer that the bonds were not bought as an investment and hence were not capital assets, and the loss was deductible as an ordinary and necessary business expense, because they were acquired solely to carry out a condition imposed by the contract under which it was manufacturing and selling machinery in the ordinary course of business, and as a mere incident to that transaction[12].

(c) Where a dealer, solely in order to insure a source of supply for its inventory, or for goods used in its business, buys securities of a manufacturer of such goods, and such securities become worthless or are sold at a loss, the resulting loss is deductible, in the year realized, as an ordinary business expense or loss[13].

(d) Where a corporation, in order to rid itself of a burdensome contract with another corporation, agreed to

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8. *Exposition Souvenir Corp. v. Commissioner*, 163 F. 2d 283 (C. A. 2, 1947).

9. Sec. 1221, Int. Rev. Code of 1954.

10. E.g., see *Joseph M. Philbin v. Com'r.*, 26 T.C. 1159 (1956) and cases there cited.

11. *Western Wine & Liquor Co. v. Com'r* (1952), 18 T.C. 1090 The Commissioner has acquiesced in this decision; to the same effect is *Clark v. Com'r* (1952), 19 T.C. 48, and *Hogg v. Allen*, 105 F. Supp. 12, affirmed 214 F. 2d 640 (1954).

12. *Com'r v. Bagley & Sewall Co.*, 221 F. 2d 944.

13. *Tulane Hardwood Lumber Co. v. Com'r*, 24 T.C. 1146; *Arlington Bowling Corp. v. Com'r*, 18 TCM 896; *Smith & Welton, Inc. v. U. S.*, 164 F. Supp. 605, 58-2 USTC Par. 9783.

and did buy the stock of the other corporation (after the latter had distributed all its assets except the contract) and then dissolved it, the cost of the stock was allowed as a business expense[14].

(e) A trade-in of business equipment, such as a truck, for new equipment is treated as an exchange involving "boot" under section 1031(a) of the Code. The Commissioner has recently ruled[15] that if, instead of entering into such a direct exchange, the parties enter into separate contracts, one covering the sale of the old equipment and the other covering the purchase of the new, the transaction still qualifies as an exchange because "a sale is to be disregarded where it is a step in a transaction the purpose of which is to make an exchange, and which results in an exchange."[16]

In the *Western Wine & Liquor Co.* case (footnote 11 above), the following extracts from the Tax Court's opinion seem to be directly in point here:

"Shall we for tax purposes split what is obviously an integrated transaction into a series of splinters; in other words 'atomize' the transaction * * *, or shall we look to what we consider the 'substance' of the plan and 'view it as a whole' "?

* * *

"The testimony and evidence establish that this taxpayer purchased the Distilling stock, not as an investment in stock, but only to acquire more whisky to replenish its inventories in order to sustain its business. * * * We think this taxpayer acquired the Distilling stock incident to the conduct of its business and not for investment and that it held the stock only long enough to acquire the whisky and then sold it to reduce the cost of the whisky as much as possible. In the circumstances * * * the sale of the securities became an incident of the business."

The Commissioner, after much litigation, has finally conceded the underlying principles of the cases just discussed[17], but distinguishes the FNMA stock deal, as being nearer the situation in the *Exposition Souvenir Corporation* case, above-mentioned.

These cases (footnotes 11-14, incl.) are cited to show the tendency of the courts to look at realities and refuse to break down one over-all deal into its components and treat each as a separate and unrelated transaction.

▶ *Viewing the Mortgage sale as a "Boot Transaction"* — Adopting the philosophy that we should look through form to substance, the facts in our case seem to establish that what has happened is that the mortgage company has disposed of property (the mortgage) for cash plus other property, or "boot" (the FNMA stock). Section 1001 of the Internal Revenue Code seems to fit the transaction exactly. It is there provided (insofar as is material here):

"(a) The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis * * * for determining gain * * *

"(b) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. * * *"

Under this approach, in the example above cited, the mortgage company would have no gain or loss on the sale of the mortgage to FNMA, since its cost ($9,700) would exactly equal the amount realized ($9,600 cash plus FNMA stock having a value of $100.00).

Furthermore, on sale of the FNMA stock, since it would be taxed only on any excess of the sale price over "cost" of the stock[18], and since "cost" of property acquired, as is this, in a taxable exchange is the value of the property when acquired[19], there would be no gain or loss. More importantly, it would not matter whether FNMA stock were received as a capital asset or as property held for sale, except to the extent that its market value changed after acquisition.

The case nearest in point that the author has found is the *Michelin Corporation* case (See Note 19). In that case, the taxpayer sold a piece of real estate for $350,000 cash plus a $350,000 10-year mortgage, which gave the mortgagor the right to anticipate the maturity and provided that if he did so within two years, the principal mortgage debt would be reduced to $300,000. The taxpayer treated the proceeds of sale as $700,000 and reported a substantial gain which, being offset by losses in other transactions in the year, resulted in practically no tax liability. The mortgagor took advantage of the prepayment privilege and, within the two-year period, paid $300,000 in full satisfaction of the mortgage. The taxpayer claimed a $50,000 loss in the latter year. However, the Court held the taxpayer should have computed his gain on sale of the property by taking that note in at its value when received, and that that value ($300,000) became the basis for future disposition of the note, so that no loss resulted in the latter year.

It will be seen that the taxpayer in the *Michelin* case took the same position as the Internal Revenue Service takes with reference to a FNMA stock deal, and the Court held that position to be unsound. What was sauce for the Government in that case should be served as sauce for the taxpayer in a situation where their positions are reversed.

▶ *The Ordinary Business Deduction Approach*—In the *Schumacher* case (see Note 7), the only reported decision involving a FNMA stock transaction, the Court did not write an opinion, but concluded as a matter of law that, where such a mortgage sale is "an incident in the regular conduct of" the business of the seller, and the seller has no intention to hold the stock as an investment, then on sale of the stock, the difference between its par value and the sale price constitutes an "ordinary business loss."

This is a somewhat different rule from that provided by statute for 1960 and subsequent years. The statute allows a deduction for the excess of par value over market value as a business expense at the time the stock is *acquired,* whereas the *Schumacher* decision allows deduction of the excess of par over sale price in the year the stock is *sold.* Likewise, the statute treats the market value of the stock at the time of acquisition as its tax basis, whereas the Court's rule ignores that value, takes the par value as basis, and finds a loss on sale of the stock in the year the stock is sold.

(Continued on page 44)

14. *Pressed Steel Car Co. v. Com'r,* 20 T.C. 198.
15. Rev. Rul. 61-119, I.R.B. 1961-26, 8.
16. To same effect: *Century Electric Co. v. Com'r,* 192 F. 2d 155 (1951).
17. Rev. Rul. 58-40, Cum. Bull. 1958-1, p. 275.
18. Section 1012, Int. Rev. Code of 1954.
19. *Countway v. Com'r* (CA 1, 1942), 127 F. 2d 69; *Forstman v. Rogers* (CA 3, 1942), 128 F. 2d 126; *Michelin Corp. v. McMahon* (D.C. N.Y. 1956), 137 F. Supp. 798, 56-1 USTC par. 9230; 3 Tax Law Rev. 351, 369.

SERVICING

THEY GET TAX BILLS DIRECT

In Florida 65 of 67 counties send them to mortgage firms

It began in 1944 when one county broke away from the old practice of sending them direct to property owners, another soon followed until now it's done practically everywhere in the state. It's meant a great saving for the municipalities, for mortgage bankers and for investors—and reflects an important example of how sincere and honest cooperation can pay off. Mr. Middleton tells how it all happened.

***By* DAN W. MIDDLETON, JR.**
Vice President,
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THE story of Florida's spectacular growth has been widely told. In the past two decades of population explosion and urban expansion, an epidemic of growing pains has spread to local tax offices and mortgage companies alike. By close teamwork, their operating procedures have been coordinated and improved to keep pace with the times and cope with the problems of changing conditions.

The timetable and methods of assessing and collecting taxes in Florida vary partially from most if not all of the other states. Florida does not levy a tax on real estate. Ad valorem taxes are reserved to counties and cities for operating local governments and public schools.

The tax assessor is responsible for finding and evaluating all taxable property in his city or county, thus establishing the tax roll. Then the tax collector has the duties of extending amounts of taxes on the tax roll at millage rates determined by the county or city commissions, city councils or other levying authorities, preparing and distributing tax bills and collecting taxes. Obviously, close cooperation between assessors and collectors is a primary ingredient to effective correlation with mortgage companies.

In six counties of our state, city and county tax assessments and collections have been consolidated under the county assessor and collector. Another county is now making this conversion under what is known as the "Metro" plan. We hope these developments may be the beginning of a new trend in this direction.

Taxes are assessed for the calendar year as of January 1. Status of a property on this date determines the basis of assessment, that is, whether a property will be evaluated as a vacant lot or as improved real estate and whether certain exemptions are allowable.

A 1938 constitutional amendment exempts all homesteads from taxation on the first $5,000 of assessed value, except for assessments for special benefits. This is a boon to builders in making sales and to homeowners but a bane to mortgage servicers who are trying to keep tax escrow deposits adequate but not excessive. For there may be no taxes at all on a residence that is totally homestead exempt but on the same property nonexempt, taxes may run up to $300 or more.

Total exemption of church properties and exemptions of taxes on $500 of assessed value to widows, disabled veterans, and other disabled persons are lesser problems.

Exemptions must be claimed each year between January 1 and April 1 by the property owner. Failure to claim means loss of the exemption. Homestead for exemption purposes is defined by constitutional amendment. Generally husband and wife hold title to their home in an estate by the entireties, that is, both own a common interest indivisible except by death or divorce. But either the husband or wife may file application for homestead exemption.

Believe it or not, each year there are a number of people who lose exemptions simply because they fail to make application for them. Others, as may be expected, claim exemptions to which they are not entitled only to have them disallowed.

We find most assessors very cooperative in furnishing valuations and exemption status. This aids in establishing tax escrow deposits on a realistic basis which reduces escrow shortages. Of course, the servicer must keep abreast of widely varying rates and rate trends in the various taxing districts to make accurate estimates of tax requirements.

In Duval County where revaluation is expected, recently appointed tax assessor Frank K. Osborn, MAI, SRA, agreed to furnish mortgage companies with projected revision figures at least a year in advance to avoid the full impact of expected tax increases hitting the homeowners all at once.

Special assessments of counties are included in regular tax bills. But cities have been a real problem with many special liens for such purposes as sewerage and drainage, curbs and gutters, sidewalks, paving, etc. Recently city tax offices have become cooperative in furnishing amounts of special liens on tax request lists.

Jacksonville has a unique plan of transferring installments on special assessments to the tax roll each year. In this manner city taxes and special assessments are included in one tax bill.

While all county taxes become payable on November 1 and the default date is April 1 of the next year, cities have varying due dates from July 1 to December 1 and default dates in the subsequent year ranging from January 1 to June 1.

Counties allow a uniform discount of 4 per cent on taxes paid in November, 3 per cent in December, 2 per cent in January, 1 per cent in February and no discount in March. Cities have discounts ranging from 4 per cent down to 1 per cent which reduce on varying bases.

A state statute provides for a charge of $1 each for furnishing duplicate tax bills and it was exacted by many tax collectors at one time or another. It appears now to be generally realized that the charge neither covers the cost of making a duplicate bill nor offsets the confusion of sending thousands of tax statements to individuals.

Anthony Schleman, tax collector of Hillsborough County (Tampa) since 1941, made the break-through in 1944 from the cumbersome practice of distributing bills to property owners. He is also the first tax collector in our state to use Addressograph equipment which was installed in 1942 under joint owership with the tax assessor. This was a tremendous step forward from the laborious manual and typewritten methods of preparing the tax roll and bills and also aids in sending statements to mortgage servicers.

The innovation of sending bills to mortgage companies was next put into practice by Clyde H. Simpson, tax collector of Duval County (Jacksonville) in 1948. Addressograph equipment had previously been installed by the late Leon Forbes, MAI, tax assessor. He made a nominal charge to the tax collector for imprinting tax bills. Sending tax statements to mortgage companies has enabled payment in large blocks by the servicers at lower cost in a more orderly manner while saving expenses in the tax collectors' offices with a smoother work flow.

Now, either Addressograph or IBM equipment is used by all of the more populous counties and cities. Most cities and 65 of Florida's 67 counties send tax statements directly to mortgage companies. One of the two exceptions indicates early adoption of this practice. The other county tax collector seems to feel that mortgage companies in his area "want all of the cooperation to be done in the tax collector's office." This emphasizes the need for all-out cooperation by mortgage servicers to gain benefits from receiving bills directly.

Under the direction of Ed T. McDowell, assistant tax collector of Duval County, a plan was originated of releasing tax bills to mortgage companies two or three months ahead of general distribution about November 1 when all county tax bills become payable. Advance distribution permits mortgage companies to pay a large portion of 162,000 Duval County real estate tax bills before November 1 when other taxpayers start the payment rush so as to save 4 per cent discount. In this manner, tax offices and mortgage companies are able to spread the peak-load of tax work over several months with benefits and savings to both.

Many tax collectors using Addressograph or IBM equipment now code their bills assigning a number to each mortgage company which facilitates sorting and mailing tax statements. Of course this necessitates full cooperation of mortgage companies in notifying the affected tax collector promptly as each new loan is set up or an old loan is terminated so as to keep records of the tax office current.

Our company has replaced traditional tax cards with Addressograph tax plates. We find this facilitates better control and quicker processing of tax bills by using pre-prepared trust fund disbursement vouchers printed with Addressograph.

Also, preparation of annual request lists to tax collectors who do not code their tax statements is expedited with tax plates. Paper slips 8½x5 are imprinted and bound with Acco fasteners. This "loose-leaf list" enables the tax collector's staff to sort out records in the sequence of his bills. Generally, tax statements are then interfiled with our slips and returned, which speeds up processing and remitting in our office.

Some occasional objection of borrowers in not getting tax receipts has been overcome by annual statements which mortgage companies send mortgagors showing taxes as well as hazard insurance or mutual mortgage premiums paid from the escrow account. Our company for several years has been sending borrowers a photocopy of the mortgage payment and escrow accounts on a request basis. This plan has proven quite satisfactory.

Some assessors have developed a numeric code system for properties. We have embossed these code numbers on our Addressograph tax plates to simplify and speed verification of property descriptions on tax bills.

With adequate control over tax payments in Florida a servicer has no need for an expensive annual tax search especially with errors and omissions coverage on taxes now included in a mortgage bankers blanket bond. Tax collectors are as enthusiastic as mortgage servicers over progress achieved in correlating tax payment procedure.

C. A. Cheesman, tax collector of Orange County (Orlando) and a past president of Florida Association of Tax Collectors, wrote, "I can't understand why any tax collector would send tax statements to the individual since, in our experience, it results in double payments and the need for duplicate statements."

"The orderly manner in which tax payments can be processed is as important to the tax office as dollar savings," commented Ed. T. McDowell, assistant tax collector of Duval County (Jacksonville). "More than 3,000 refunds of duplicate payments were made during the last tax period that bills were sent to individual owners."

Anthony Schleman, tax collector of Hillsborough County (Tampa) exclaimed, "It is better for my office to send tax bills to mortgage companies because I can save the taxpayers' money and eliminate extra work involved in duplication of payments and billings."

We feel here in Florida that our joint effort with tax collectors and assessors has been well worthwhile not only in savings and benefits to tax offices and mortgage companies, but also in enabling us to provide better service to mortgagors and investors. We believe tax collectors and mortgage servicers in all other states will find that working together is profitable and beneficial to both, but cooperation is the key — real, earnest, mutual cooperation.

What's Coming in Home Building

▸ *Changes are everywhere but the principal ones are still ahead*

HOME-BUILDING industry has been going through a trying time these past few years but it is in a state of transition now. Subterranean changes in the making during the past decade are now beginning to show their effects. We are undergoing the transition from a period of postwar shortages, of unsatisfied demand, and vast sums of idle capital to a period of capital shortages and a completely different kind of market.

In the last 15 years, the home-building industry has built over 15 million dwelling units and has added close to $150 billion to our national wealth. It is the largest user of private credit in the country.

As recently as 1940, only 40 per cent of our people owned their own homes. We had only 11 million home owners in 1940 while today some 29 million families own their own homes. Today, 60 per cent of our households live in homes they own. This is a major social revolution to which all too little attention has been paid.

The next 10 years will provide many vital challenges for the home-building industry.

At a *minimum,* we will have to develop more than 4 million acres of land into the new communities and into the new suburbs which will spring up around all our cities.

At a *minimum,* it will require $150 billion net of new investment capital. In the next 10 years, we will see three basic changes in the home-building industry—changes in markets, in relationships with government, and changes in the basic nature of the industry itself.

Today's home-building markets differ considerably from those of the past. We have in the postwar years so far satisfied the needs of that portion of the market which it was easiest to satisfy. We must now move more vigorously on the provision of better housing for that portion of the market which it may be more difficult to satisfy. We must develop, promote, and sell the new markets that can be brought into being with the right product, properly priced. The potential market will come from:

▸ A new kind of high-quality home for lower-income families who may want and need better housing, who have the income wherewithal to sustain purchase, but for whom a satisfactory high-value, low-priced home has not yet been produced in quantity.

▸ Retirees, or those about ready to retire.

▸ More housing opportunities for minority families.

▸ More housing opportunities for citizens of our smaller towns and cities which have been bypassed, for one reason or another, during the housing boom of the postwar period.

▸ Upgrading the housing standards of those living in adequate shelter, but in housing which is not properly suited to the needs of their families.

The second major change to look forward to in the coming decade is in the role of government. Over the last 15 years, the actions of the federal government in the field of legislation and monetary and fiscal policy have been of tremendous importance in the home-building industry. Prior to the 1930's, the government played practically no role at all. Since then, we have seen legislation providing for the Federal Home Loan Bank System, the FHA mortgage insurance, the VA program, FNMA, and a vast undertaking in the field of urban renewal.

The third major change is within the industry itself. One of the most significant changes in the last few years is the realization by major industrial corporations of the markets that could be available for them in housing. These corporations are engaging in research, in development, in marketing and merchandising; and they are working with builders to increase the housing market. Even the builder has changed markedly in these years. The builder is becoming a business man, assembler, and has moved away from the role of the small scale artisan building one or two houses a year. He has become interested in the problem of merchandising or market development. These are major revolutions as anyone who has watched the industry for years can attest.

We are now in a period in which the cumulative effect of these changes is becoming evident. The building industry has undergone major changes and is on the threshold of still more. Whether my feeling about the future is correct or not, only time can tell, but we cannot make our plans on what tomorrow may tell us about today. Hindsight may be more accurate than foresight—but it is somewhat less useful since all you do with hindsight is wait for it and sit on it.

By NATHANIEL H. ROGG

Director, Economics Department, NAHB
at ABA's First National Mortgage Conference

Scheduled for September

September, heretofore a month which has rarely seen an MBA meeting, this year will see two of the most important meetings the Association has sponsored. One, the National Electronics Convention in Detroit, has a meaning for and appeal to every mortgage banking firm; the second, the Mortgage Seminar for Trusteed Funds in Chicago, is not for mortgage bankers but the benefits of it will accrue directly to them. And after these two September meetings is MBA's 48th annual Convention in Miami Beach.

NATIONAL ELECTRONICS CONVENTION
Statler-Hilton Hotel, Detroit
September 11-14, 1961

Although MBA previously sponsored an Electronics Conference in New York several years ago, the National Electronics Convention which its Servicing Committee is sponsoring in Detroit, is in the nature of something brand new. It is a four-day meeting where those attending will be exposed to every development of the recent past in the world of electronic development as it applies to mortgage loan servicing and see as well everything that is new and up-to-the-minute. Twenty of the country's principal manufacturers of electronic equipment for mortgage loan servicing will have their products on display; thus those who are there will have an opportunity to see "everything in electronics."


J. C. Smith, Jr.

The Convention is for firms using such equipment now, those just beginning its use and those contemplating an electronics operation. The four-day Convention contains a heavy schedule of lectures, talks, demonstrations and inspections, all under the direction of competent authorities and expert counselors. MBA President Robert Tharpe will discuss "Automation and Progress" and the speaker at a luncheon session on September 14 will be James C. Smith, Jr., assistant general manager of the Missile Division of Chrysler Corporation. Co-chairmen of the Convention, and the designers of the meeting itself, are W. W. Dwire, vice president, Citizens Mortgage Corporation, Detroit and Edward J. DeYoung, vice president and controller, First Federal Savings of Detroit, with James G. Wasson and Robert J. Murphy, director and assistant director respectively, of MBA's accounting and servicing division, acting co-ordinators.

Other Committee members are Joe Engleman, director of special projects, Mutual Life Insurance Company of New York, New York; L. K. Horn, vice president, Lon Worth Crow Company, Miami; A. A. Johnson, vice president, Colonial Mortgage Service Company, Upper Darby, Pennsylvania; A. F. Potenziani, president, Mountain States Investment Corporation, Albuquerque; William F. Schreiber, vice president and controller, Erie County Savings Bank, Buffalo, New York and William C. Shannon, vice president, Manufacturers National Bank of Detroit.

The Detroit meeting has unique importance for MBA members because it points the way to the future course of mortgage servicing. It's about what is here now and what is coming and, above all, it will show how the ultimate in efficiency and economy can be achieved in the servicing side of a mortgage operation.

MORTGAGE SEMINAR FOR TRUSTEED FUNDS
Sheraton Chicago Hotel, Chicago
September 15, 1961

Last year in New York MBA held—for the first time—a meeting under this same title; this September the program is being repeated but for an entirely new group of administrators, managers and trustees of pension funds. In New York more than 150 attended, representing every conceivable type of fund. The object was to demonstrate to these managers that the field of mortgage investment is one that they enter with every prospect of attractive return and with no more "red tape" than encountered in any other investment area.

Results of the New York Seminar were highly favorable, the Chicago experience should be equally so. The meeting is *not* for MBA members but the advantages stemming from it will redound to member firms in the greater appreciation that these managers will have of the mortgage as an investment for their funds.

And After September—
MBA 48th CONVENTION
Miami Beach

And after the September meetings comes the highlight occasion of this or any MBA year, the annual Convention. This year it's a vast panorama of ideas, of discussion and examination of our field of mortgage lending. There's a fine program in store, some excellent Workshop sessions to get at the fundamentals of our business and a full review of the new things in the government-sponsored phase of mortgage financing. But the Convention is many other things as well. The Farm Loan Committee in sponsoring a tour of Florida farms; the YMAC Committee is sponsoring a special meeting to explore Unusual Commercial Loans and a golf tournament as well; there's a full program for the ladies with attractive events planned for them. There's a fishing tournament and the social highlight of the four-day conclave is the Pan American Carnival, an elaborate dinner party with a great show with emphasis on Latin America. Plan now to attend!

At the School: MBA President Robert Tharpe; right, at the graduation night dinner, Dr. W. G. Heusen, professor of finance, University of Miami, Coral Gables; Dr. Harold G. Torgerson, Northwestern; L. O. Kerwood; Louis P. Wolfort, chairman, MBA Educational Committee; Dr. Kenneth McFarland, who delivered the graduation address; President Tharpe; Frank J. McCabe, Jr., MBA executive vice president and Alan B. Ives, assistant to the president of Lon Worth Crow Company, Miami, who delivered the class response.

Graduation in MBA

MBA's School of Mortgage Banking, the one and only educational effort in the field of mortgage lending and investing, began and completed another year—and it was a record year for attendance. Graduates numbered 125 and at the same time a new freshman class of 122 students from 28 states, the District of Columbia and Puerto Rico was admitted to begin the three-year course of instruction leading to graduation. The sophomore class, the Course II students, numbered 109 from 32 states and the District of Columbia, Puerto Rico and Canada. That's a total of 356 who were at the Chicago Campus of Northwestern University for instruction. Courses I and II were, of course, also held at Stanford University in California in July and August and attendance there indicated another record.

And so another year began and closed for MBA's School of Mortgage Banking. Each year each class represents just about the group that can best be accommodated in an educational effort of this kind. Each year there is something new added to the curriculum, something else is broadened and expanded and each year the School takes another step to academic excellence.

Graduation, regardless of the time of life or the school, can be a glad time and a sad time. This year 125 were graduated from the School and it was a glad time because of the courses completed, the training absorbed and the contacts made—but, no doubt, many had a wistful feeling that it marked the end of this particular road. Three of the 125 who got their diplomas, left to right, were Robert W. Guiles of James T. Barnes Company, Detroit, William L. Loizeaux of John Burnham Company, San Diego and—one of the most attractive members of this or any other graduating class—Ann Highsmith of The Commercial Trust Company of Atlanta. And that's MBA President Robert Tharpe awarding the sheepskins.

The School of Mortgage Banking is many things, many efforts involving many people with the single objective of bringing mortgage banking to still higher professional levels than it has already achieved. The academic course is carefully planned but added to it are many moments when students have the opportunity to be with, and consult with, those who have accumulated long years of experience in the field. At one of these, upper left, there is MBA Second Vice President Dale M. Thompson; William G. Hayward, First Mortgage Corporation, Richmond; Robert J. Sinnenberg, Teachers Insurance and Annuity Association, New York City; and Robert E. Skold, Mutual Benefit Life Insurance Company, Newark.

Upper right, Denzil O. Nichols, Frederick W. Berens, Inc., Washington, D. C.; William E. Bieman, The Marine Trust Company of Western New York, Buffalo; Leif Gran, T. J. Bettes Company, Houston; and Edward Mirick, T. J. Bettes Company, Houston.

Upper left, an informal group at one of the sessions outside the academic halls; and, at right, a get-acquainted dinner. Below left, Harold E. Marsh, Jr., assistant vice president, T. J. Bettes Company, Oklahoma City; Donald A. Duprey, assistant cashier, Security Bank, Lincoln Park, Michigan; Robert F. Plymate, Pool Mortgage Company, Chickasha, Okla.; and Clayton S. Bisley, Connecticut General Life Insurance Company, Hartford. Below right, Dr. Torgerson, and Messrs. Kerwood, Thompson and McCabe.

Other MBAs

M. J. Greene Named President of Dallas MBA

M. J. Greene, right, vice president, Southern Trust & Mortgage Co., is the new president of Dallas MBA. Other new officers are A. G. Wallace, left, vice president, First National Bank, secretary and treasurer, and Robert D. Johnson, center, general manager, Murray Investment Co., vice president. They're shown at election meeting.

Lubbock MBA Sponsors Mortgage Bankers Day

The Lubbock Texas MBA, which in recent years has maintained a program of activities comparable to associations in the larger metropolitan areas, has named a new slate of officers for the coming year—and, at the same time succeeded in sponsoring one of the most successful Mortgage Bankers Days. The latter was at Texas Technological College in Lubbock, in cooperation with the School's department of business administration and the business fraternity, Delta Sigma Pi. Talks were by Jerome L. Howard, president, Mortgage and Trust, Inc., Houston; M. J. Mittenthal, immediate past president, Texas MBA; E. T. Compere, Jr., director, National Association of Real Estate Boards, Abilene; and Lewis O. Kerwood, MBA director of education and research.

More than 165 attended the Mortgage Bankers Day morning session and about 150 of the senior finance students and local mortgage bankers attended the luncheon. These Mortgage Banker Days have been held in colleges and universities over the country with the purpose of focusing attention on the mortgage industry as a career for young men and women and have proved highly successful.

Above, new officers of the Lubbock MBA are, left to right, R. G. Armstrong, assistant vice president, T. J. Bettes Company, director; William J. Morrow, vice president, Mortgage and Trust, Inc., vice president; William H. Pearce, assistant vice president, J. E. Foster & Son, Inc., president; and Coffee R. Conner, vice president, The Lubbock National Bank, retiring president and director. Standing, left to right, Jack Gaulding, assistant mortgage loan officer, The Lubbock National Bank, director, and Henry Jones, vice president, Investors, Inc., director. Officers not shown are Robert E. Hamilton, loan supervisor, American General Investment Corporation, secretary; and Tim Tinsley, assistant vice president, Gulf Coast Investment Corporation, director.

Jerome Howard Named Houston MBA President

Houston MBA elected Jerome L. Howard, president, Mortgage and Trust, Inc., as president for the new year. First vice president is J. Ray Driver, vice president, Kinghorn, Driver & Co.; second vice president, Arthur Littell, vice president, secretary and treasurer, South Coast Life Insurance Company; secretary-treasurer, Edward R. Godwin, executive vice of Texas Mortgage Investment Corp. Howard succeeds Travis Traylor, president, Union Mortgage Company. He is also vice president of the Houston Board of Realtors and on the board of the Houston Home Builders Association.

Robert Y. Amrine New Head of Arizona MBA

Robert Y. Amrine, vice president, First Federal Savings and Loan Association, is the new president for the 1961-62 term of Arizona MBA, succeeding J. W. Blundell, executive vice president, Western American Mortgage Co. Warren O. Sutton, Pacific Mutual Life Insurance Company, was elected vice president and Norman R.

(Continued on next page)

New MBA Organized in Eastern Michigan

A new regional mortgage bankers association, the Eastern Michigan MBA, has been organized with members including all institutional type lenders in the territory which covers the eastern half of the State. Roger N. Pierce, president, George O. Fetters and Company, Saginaw, was elected president.

Other officers are vice president, A. F. DeYonker, vice president, Michigan National Bank, Flint; treasurer, Fred Dingwall, president, Savings & Loan Association, Owosso; secretary, Raymond Kelly, vice president, Cook & Kelly Mortgage Co., Flint.

Directors, besides the officers, are John Metzger, vice president, Frankenmuth State Bank and Roland Parker of the First Federal Savings & Loan Association, Flint.

Hall, vice president, A. B. Robbs Trust Co., was elected secretary-treasurer. All are from Phoenix.

The New Jersey MBA, in cooperation with the New Jersey Bankers Association, will sponsor a Mortgage Lending Conference September 29 in Haddonfield, N. J., with MBA Vice President Carton S. Stallard; MBA General Counsel Samuel E. Neel and Charles J. Horn, vice president, National State Bank of Newark, on the program.

Cincinnati Names L. L. Wallingford

Landon L. Wallingford, center, of Walldon, Inc., was elected president of the Cincinnati MBA. Other new officers, left to right, are John P. Bell, Fifth Third Union Trust Co., treasurer; Thomas N. Berry, Central Trust Co., secretary; James L. Stevenson, Pan Ohio Mortgages, Inc., vice president, and John Rutledge, trustee. Not shown is Walter Kautz, who was elected trustee. *(photo below)*

URBAN AFFAIRS & HOUSING

(from page 26)

functions designated in the legislation, the other agencies dealing with nonfarm residential mortgage credit, namely, the loan guaranty system of the Veterans Administration and the Federal Home Loan Bank Board.

If these changes are made, many of the apprehensions created by the present bill would be reduced and the confidence of the private organizations and institutions on which any government program must ultimately depend would be enhanced. If these changes are not feasible at this time, it would be preferable to continue the existing arrangement in order to allow the opportunity for fuller consideration of all the questions that are involved and the undesirable consequences that appear certain to follow the creation of a new department as provided for in the present bill.

REAL ESTATE BUST?

(from page 13)

right to run the building and collect its rents—on the entire property for $5 million. He received $1.5 million in cash and took a mortgage of $3.5 million to cover the rest. This was a mutually advantageous arrangement to both parties. The party that leased the building had to remit to Zeckendorf $600,000 a year to pay off its mortgage plus interest on the lease; but since the annual profit from the building was $1 million a year, the investors made about $400,000 a year, or a return of 8 per cent on their $5 million investment.

However, Zeckendorf was just beginning. He went to a mortgage company and borrowed $6,750,000 at 4.5 per cent on the property, which of course he still owned. Soon after, the rents in the building were raised, enabling Zeckendorf to borrow an additional $2,250,000 in the form of a second mortgage. He thus had received a total of $14 million for a property estimated to be worth less than $10 million. And he still held the title to the building itself—for which he turned down an offer of another $1 million.

Zeckendorf, in short, found a way to wring 50 per cent more money out of the building by dividing its values into separate parts. He went on to perfect this technique in his subsequent purchases of the Graybar and Chrysler buildings near Grand Central Station. And as others saw what he was doing, they started imitating his methods.

But the basis of this kind of financing is a continually improving market. As long as rents go up and up, and the interest rate soars, the position of such speculators can generally be maintained, although sometimes with peril. However, realtors with many years of background shudder to think what would happen to buildings laden with top-heavy mortgages if ever there were a downward dip in our economy.

It is doubtful if the present rickety structure and inflated values of the building industry would ever have been possible if it were not for the device called the syndicate. A syndicate is merely a group of people who get together and form a partnership, sharing profits in proportion to their financial participation. The attraction of the syndicate is its tax position. Corporations are taxed twice, first on their normal income, then on their dividends; but the members of the syndicate pay taxes only once, like any individual. Furthermore, the tax deduction for the depreciation on property is allowed to the corporation which owns it, but not to the corporation's stockholders; in contrast, each member of a syndicate can deduct for depreciation on syndicate-owned property on his own tax return.

These simple facts have transformed New York real estate. Property is appraised according to the return it brings investors, and the effect of the syndicate has been quite simply to double values. A building worth $5 million to a corporation is now worth $10 million to a syndicate. And since at each sale a new depreciation allowance is set up based on the new selling price, the syndicates can afford to buy buildings at a higher price, feeling sure that they are adding tax-free dollars to the income of their investors.

Suppose that a building worth $5 million is coming to the end of its depreciation deduction. If a syndicate buys it for $10 million, it is allowed to deduct for depreciation the added $5 million in value (minus the land value, which is non-depreciable). The accelerated depreciation allowance I have described then comes into play. During the early years of their ownership the members of the syndicate will share tax deductions amounting to hundreds of thousands of dollars.

The syndicate device came into wide use in the early 'fifties, and it was recently reinforced by the passage of the Real Estate Investment Trust Act. Building after building, hotel after hotel, apartment after apartment, have fallen to the scythes of the syndicates. As buildings get older,

their depreciation runs out and the owners are inclined to sell, especially if a syndicate comes to them offering twice what the owner thought the property was worth. And the process feeds on itself. The syndicates have been offering participants from 10 per cent to 12 per cent annual profit, part of it tax-free, and more and more money pours into their portfolios.

The consequence of this frenzied investment is alarming: as the value of New York real estate has soared to absurd heights, the market has been picked as clean of likely purchases as the dead carcass of a cow by ants. The builders in turn feel compelled to erect new structures, knowing that even if they rent with only partial success, they can immediately sell at a profit.

Today all the devices available to the real estate millionaires—building on leased land, accelerated depreciation, capital gains, and syndicate operations—have combined to set in motion a wild spiral of construction and speculation. Unless this spiral is checked, weight will pile on weight until the whole precarious structure may collapse into a terrible shambles.

We have seen the financial reasons why buildings are springing up all over New York—and other cities—with such bewildering and dangerous speed. How about the buildings themselves? What are they like to live and work in? The answer, unfortunately, follows straight from the pattern of the real estate market I have just described: the cheaper the product, the higher the return. As costs of construction have been rising, builders have found formulas to substitute tinsel for quality, squeezing out every penny of profit they can.

Consider the question of crowding. It has become so apparent that builders are intent on covering every possible inch of New York with construction that when rare exceptions occur —such as the Lever Brothers and Seagram buildings on Park Avenue —the news hits the front pages of the newspapers. Of course it is difficult to convince the builders that crowding massive structures over narrow streets ruins the aesthetic effect of architecture. They are businessmen concerned not with aesthetics but with getting the most rent per square foot out of their investment. However, when the public allows the quest for profit to dominate architectural values and the municipal interest almost *completely*, as it has done, it is accepting a monetary perversion which seems beyond that of any known previous civilization.

Why, for instance, do we see all over New York the so-called "Babylonian effect"—buildings featuring graduated setbacks every three stories? This "style" is nothing more than the builder's way of getting maximum vertical land use while conforming to the city's antiquated building code. More recently, a new style has become popular—a tower rising from a block base—not because of some weird conversion of the builders to aesthetic values, but rather because the rising costs of roofing material and plumbing made the numerous setbacks more expensive.

Architecture in New York has become so tawdry and buildings so jammed together that public pressure finally forced some hopeful changes in the Municipal Code just this past year. However, any building for which plans are filed before November 1961 can be built under the old code. A recent wave of applications assures us that almost every edifice of any size over the next four years will be constructed in the same mediocre pattern.

Striving to profit from every foot of land, the speculator must still attract his tenants, so he tries to "glamorize" the public parts of the building. Typically, he builds a fancy lobby and decorates with an abstract mobile or a ceramic design as a sop to "modern architecture"—Noguchi's designs have become a favorite for this today. For the outer shell of the building, the speculator uses precast stainless steel cubes, cream plastic plates, or colored aluminum sections. These thinly veneered skin treatments are "modern" too and they cost less than the traditional brick or stone. It is irrelevant that one day they may leak like a sieve: the tenants won't find this out until they are well along on their long-term leases.

The newest prestige attractions are the elevators: wired to play soft semi-classical tunes, they glide up and down without operators, saving the builder up to 25 cents per square foot in labor cost. (Tenants now actually *want* operatorless cabs. The newest buildings have them—therefore they must be better.)

The lobby, façade, and elevators are the glamour centers of the building. Where the speculator recoups is in mechanical equipment, especially air conditioning. Since the difference between good and bad air conditioning can run as high as $3 per square foot, and since the average office structure today is over 300,000 square feet, this item alone can save the

(Continued on page 41)

NOTE TO MEMBERS:

On the opposite page is an advertisement in which the New York Legal Exchange, Inc. announces the availability of individual investment reports on various types of pension funds. This information should not be confused with MBA's "Partial Listing of Existing Trusteed Funds" which was intended only as a guide. The financial information provided by the New York Legal Exchange, Inc. is shown in the report reproduced below:

DEPT. OF LABOR FILE #71167

COMPANY NAME General Electric Co.

NAME OF PLAN General Electric Pension Plan

STREET 570 Lexington Avenue

CITY New York 22 STATE New York

ADMINISTRATOR Trustees: Philip D. Reed, J. D. Lockton, E. G. Kinloch, C. W. La Pierre, G. L. Phillippe

NUMBER OF EMPLOYEES FUND COVERS
249,054

CORPORATE TRUSTEE Self-administered

CASH	$ 1,779,157
BONDS AND DEBENTURES	
(a) GOVERNMENT OBLIGATIONS	20,489,059
(b) NONGOVERNMENT BONDS	438,517,138
STOCKS	
(a) PREFERRED	
(b) COMMON	325,244,896
COMMON TRUSTS	
REAL ESTATE LOANS AND MORTGAGES	79,670,469
OPERATED REAL ESTATE (leasebacks)	151,084,962
OTHER INVESTMENT ASSETS	9,294,849
ACCRUED INCOME RECEIVABLE ON INVESTMENTS	6,219,459
PREPAID EXPENSES	
OTHER ASSETS	
(a) empl. contrib. receivable	3,028,896
(b) company contrib. receivable	15,923,894
(c) sundry debtors	5,376
TOTAL ASSETS	$1,051,258,155
TOTAL ANNUAL RECEIPTS	$ 112,733,292

BASIS FOR DETERMINING AMOUNT AT WHICH SECURITIES ARE CARRIED ________ ACCOUNTING BASIS Accrual

builder almost one million. A good air-conditioning system should have controls for air on each side of the building as well as the upper and lower parts. It should have plenty of return ducts to carry out the stale air. Above all, to cope with sharp variations of temperature in spring and autumn, it should have large entry ducts which permit the air to be completely replaced by fresh air in a short period of time.

A defective air-conditioning system suits the purposes of present-day builders perfectly because the prospective tenant will not see it. He cannot tell the difference between good and bad air flow by looking at the plans. When more sophisticated tenants call in engineers to review the design of the air conditioning, the builder usually compromises by improving the system for the executive offices while continuing to save on the unimproved clerical areas.

(In defense of the builders, it might be added that they are not solely at fault. Many sectors of the elevator and air-conditioning industries are controlled by a few corporations which—as any buying agent in the construction field could testify—maintain prices by refusing to bid competitively. Instead they "respect" one another's business and apportion the work. Recently I was amazed to discover that a bid for air-conditioning equipment broke this rule. It would seem that the companies are so shaken by the recent GE-Westinghouse prosecutions for price fixing that they have now *agreed* to compete, at least for a time.)

Cheap and inadequate mechanical equipment is only one of the devices used by builders to cut costs and run up profits. It is impossible to list all the tricks of the trade in this article but here are some of the more common ones:

The Strange Theory of Large Office Areas: By a careful campaign of public hypnosis, the builders have convinced many tenants that tremendous floors are ideal for modern office layout. In fact, objective management studies have shown that the ideal layout space for most large firms varies between 12,000 and 20,000 square feet. However, it is in the builder's interest to convince the tenant that much larger floor areas are desirable because the larger the cubic area, the cheaper it is to build. Two stairways as fire exits and one fire-tower air shaft are needed in a small building as well as a large. The bigger the floors, the fewer the toilets per square foot to be installed—and less air conditioning is needed because of the smaller sun-load. And there are other advantages for the builder. Almost all the topnotch speculative builders have therefore hired Madison Avenue publicists to persuade tenants that they need enormous floors, and one of the most striking phenomena of real estate today is their almost complete success.

The Fictions of Space: The builders have also found ways to make the tenants pay for space they don't use. Until 1953, tenants did not pay rent for corridors, toilets, air-conditioning fan rooms, slop-sink closets, and electric and telephone rooms. Then the Real Estate Board of New York, a private organization developed to defend realty interests, decreed a new method of computing footage. The tenant is now required to pay for everything on a single-occupancy floor except the stairs, fire-tower shaft, and elevator space. For the landlord this means between 7 per cent and 12 per cent more rent from the same space.

And there are other, less obvious ways to increase charges for space. Few buildings are built on exact right angles and straight lines, flush with the edge of the building lot as drawn on the blueprints. When a building is constructed askew so the tenant has less space than the plans call for, the landlord nevertheless gives himself the "benefit of the doubt" and charges for the space anyway. Another universal practice is to charge rent for the space used by air-conditioning enclosures which protrude from the side walls.

These tricks may sound trifling but real estate insiders calculate that the shrewdest operators who exploit them all are charging for nearly 20 per cent more space than would be allowable by traditional methods. If we remember that the speculator seldom puts up more than one-third of the cash cost of the building, it should not be hard to understand why so much money pours into construction today.

Escalating Maintenance: Practically all modern leases contain a so-called "escalation clause" which provides that all increases in labor and maintenance costs, as well as taxes, will be borne by the tenants in proportion to the size of their rent or space. This is a reasonable way to protect fair-minded landlords against inflation. But some ruthless landlords have turned it into a bonanza. One classic gambit is to delay contracting for elevator maintenance during the first year of the lease. This maintenance is expensive—the large com-

panies charge about $2,500 a cab annually. When the second year begins, the landlord makes his contract, claims he has had a "rise" in costs, and charges it to the tenants. In a building containing fifteen elevators and 400,000 square feet, such a contract would run to $37,500 annually. The landlord thus picks up what amounts to extra rent of almost ten cents a square foot.

And there are other costs that get charged to tenants via the escalator clause—not to mention the dull-witted relative who pops up as a vitally needed "new" mechanic.

Multiplying Corporations: Real estate management is also peculiarly adapted to setting up a series of corporations for different building jobs, thus gaining tax advantages, since corporations are taxed only 30 per cent up to the first $25,000 of profit. Also, it is easy enough to set up corporations separating the management of a building from ownership—juggling rent, salaries, and benefits back and forth to gain the most favorable tax position.

An advantage in the Stock Market: The Internal Revenue Service has accorded real estate corporations very large and special opportunities to invest their profits outside the real estate business at reduced taxes. If an individual invests in the stock market, he must pay the normal full tax on dividends. However, once a realty corporation has paid its regular tax on its business profits, it is entitled to a tax exemption of 85 per cent on its additional profits when invested elsewhere.

This means, for example, that a realty corporation can invest in the stock market and pay less than 8 per cent tax on any dividends it receives: since 85 per cent of the dividends are tax-exempt, the normal 52 per cent corporate tax applies only to the remaining 15 per cent. And if the stock is sold at any increased value, the corporation would pay only a capital-gains tax of 25 per cent on its profit. By contrast, if its profits were invested in real estate, it would have to pay the full 52 per cent on any further profits that accrued. The real estate operators have no cause to complain that their money is "frozen" in real estate.

It should be clear that the builders are receiving extremely favorable treatment from the government. The consequences of this treatment present serious social problems.

For instance, even the most superficial observer cannot fail to be struck by the amount of architectural mediocrity the building boom has already created in New York. The big speculators have actually developed distinctive styles which now reappear with monotonous regularity, using the same mechanical patterns over and over again. The Uris brothers, for example, use colored plastic discs behind aluminum fins; the Tishmans, concrete blocks on which are pasted gigantic enlargements of a microscopic picture of a fly's eye. The busy architectural firm of Emery Roth and Sons has dotted Third Avenue and Park Avenue with squat boxes—a kind of Rothville in High Speculator Style.

Yet, given the frenetic conditions which government tax favoritism has created in the money market—and the inflated costs of construction—a speculative builder who insisted on high architectural standards would need extraordinary resources and fortitude to survive. The few worthy and interesting new buildings in the city have been put up by billion-dollar corporations as showplaces for their home offices. And even these are plagued by the problem of the setting in which they are placed. Leonardo da Vinci observed centuries ago that a building should rise in height only one-half the distance of the free span of space before it. This is a rule which has been followed in Paris, Rome, Buenos Aires, and Rio de Janeiro—and sometimes in Milwaukee, San Francisco, and New Orleans as well. The beauty of these cities is that a sense of space gives grandeur to the more notable structures—structures often devoted to civic interests and the arts and sciences, incidentally, as well as to soap, whiskey, and fertilizers.

What is particularly depressing about New York is that its building code has for years encouraged precisely the reverse effect, stifling the human instinct for dignity and grace, and creating a situation that is practically impossible to rectify within the near future. Furthermore, whatever open spaces and vistas remain are rapidly being filled in. (Two of the many examples: The development of Sixth Avenue in the West Fifties is destroying the majesty of the Rockefeller center grouping; and the sale of a small square to the south of Columbus Circle for use by the Huntington Hartford Museum means that the white lines of the New York Coliseum are muffled from the Broadway approach.)

But if the city is indifferent to the aesthetics of the building boom, it seems positively bent on strangling itself when it comes to its practical consequences. For instance, the choking flood of automobile traffic in New York is at its worst precisely in those downtown and midtown areas where more and more buildings are being constructed. It is an act of municipal madness to dump 25,000 to 50,000 more people into the crowded heart of the midtown area by permitting construction of the new Pan Am building near Grand Central Station; but the project moves forward. (Meanwhile, the obvious equations of the municipal traffic dilemma yawn in all our faces: Mass transit by trains and buses can transport 40,000 people on the same amount of roadway which can carry only 1,600 people in private cars—twenty-five times as many. But municipal and state governments refuse to subsidize railroads and bus lines, and they have become so expensive, uncomfortable, and dilapidated that people prefer to bring more and more cars into the city.)

Finally, the rising prices of land during the building boom have inexorably created a series of economic ghettos in New York which are the very antithesis of democracy. The rich and poor used to live close together but this is much less true today. Public housing brings the lucky poor together, while the unlucky poor live in strata of disgraceful tenements. The Protestant whites have largely left the city and the Jews are following. The East Side is becoming an exclusive ghetto itself, the last protected haven of the rich. As an example, a large plot on the East Side was offered to me three years ago at $70 per square foot. It seemed outrageous at the time but the same plot recently sold at over $100 per square foot. New York will soon resemble a grotesquely enlarged medieval town with each caste in its own quarter.

To comprehend the full power behind the insensate march of Manhattan building, one must take account of the activity that goes on inside the office buildings themselves—the great hives of New York advertising, market speculation, publicity, merchandising, television. In most of them you can find the same cast of mind which marks the building's construction—the same buzzing obsession with profits and tax gimmicks and quick turnover, to the neglect of solid utility and values adding grace to human existence.

The real villain, in short, is human nature itself, that part of most of us —myself included—which cannot resist a fast buck and the approval of the mob. The public at large seems to find little to criticize in the success of the new real estate millionaires; on the contrary, they are admired citizens, heroes of a kind. As long as predatory cunning and acquisitive lust pass as social virtues, the real estate speculator and shoddy buildings will be with us.

Nevertheless, the building boom itself and the laws that subsidize it present immediate dangers to our economy which we will ignore only at grave peril. From the most practical and hard-headed business standpoint, there are compelling reasons to change the tax and administrative laws before overbuilding sets off a panic which leads to a new depression. Anyone who regards the present frenzy of construction calmly will do well to remember that many of America's depressions were initiated by a spiral in land prices and overbuilding that brought down the banks. Land speculation led to the panics in 1836, 1857, and 1873. The depression of 1929 was preceded by a tremendous overexpansion of building in the late 1920s; with the fall in stock prices was coupled a drop of some 80 per cent in land prices.

What is the situation today? Paper prices for land are nearly twice the national debt; six times the federal revenue; almost twice the price of all listed stocks; and more than twice the assets of all commercial banks put together. Today, almost 15 million square feet of office space is being designed in the New York area alone. And building costs continue to stand at an all-time high.

What is the federal government doing about it? Not only does it continue to maintain the remarkable tax benefits to builders that I have described, but it also has recently approved the new Real Estate Investment Trust Bill which extends the scope of the syndicate method, making it possible for pension funds, small merchants, and hopeful shopgirls to buy "a piece of building." How are they to know that the buildings can be milked of value by smart speculators until the certificates owned by the small investors may be worthless?

People will differ on the precise reforms needed, but there is no question that changes must be made before it is too late. My own view of an equitable program would run along these lines:

▶ The privilege of tax deductions for depreciation on buildings must be completely re-examined. Certainly the present allowance of deductions for accelerated depreciation is inequitable and should be discontinued. In many European countries; no tax deductions at all are allowed for depreciation on buildings of any kind. Nor are home owners in this country allowed to deduct for depreciation. It is an open question whether business should be allowed to enjoy advantages denied to the home owner.

▶ Syndicates and the new real estate investment trusts should not be allowed to pay a single tax while corporations are taxed twice. They should be subject to the same taxes as regular corporations. The privilege they now enjoy favors one class of investors against another and is thoroughly un-American in the most abused sense of the word.

▶ Most important of all, the privilege of paying the low capital-gains tax should be completely re-examined and either eliminated or made more meaningful. Concerning the sale of property, a capital-gains tax might be valid if the property were held for a minimum of, say, ten years. In general the present capital-gains rule is a specious dodge based on the fiction that capital held over six months is a "long-term investment." The harbor of capital gains is the anchorage for the overwhelming mass of speculation both in real estate and the stock market, and as such it is heavily responsible for the violent cycles and distortions of the American economy.

It would be foolish to be optimistic about the chances of these reforms to succeed. As the recent passage of the Real Estate Investment Trust Bill showed, the real estate interests have strong influence in the legislatures. Many of the voters themselves share the dream of cashing in on the great inflation of speculative values that our laws have set in motion. Is our society capable of reform in a time of apparent prosperity—or must we wait until the whole structure collapses of its own weight?

I must add a personal postcript. I am a product of the real estate world. My entire business life—and that of my family for almost half a century —has been centered around the building and management of property. No doubt I will be called a "traitor to my class" by many relatives and friends for advocating these reforms. To them, I can only say that, from the perspective of economic history, the suggestions I have made are relatively mild. Landlords are the easiest persons to attack in times of poverty because they are few and tenants many. If another depression ensues, it will produce laws which will make the reforms I advocate seem like those of an extreme conservative. For me, it is not only immoral—in the purest and deepest sense of that word —for enormous real estate profits to be accumulated through tax tricks while 14 per cent of the Negro and 8 per cent of the white workers in America have no jobs. It is also a threat to the nation's economic stability which we must meet before it is too late.

The mortgage industry consumes more new capital than any other in this country and a substantial portion clears through that part represented in MBA; yet only a minor portion of those who make up mortgage banking identify themselves as MORTGAGE BANKERS. It is to the advantage of every mortgage banker to say—every place and on every occasion—that he is a MORTGAGE BANKER.

SELLING FNMA STOCK

(Continued from page 29)

If the sound theory is that, because the taxpayer, as an ordinary incident of a business transaction, is forced to take stock at its par value, when the actual value is less, the excess is a necessary expense of doing business, then logic would seem to dictate that that excess should be measured as of the time the taxpayer receives the stock and is in a position to fix the actual financial result of the transaction through a sale of the stock. Subsequent fluctuations in value of the stock might result in gain or loss, but such result would be attributable to extraneous circumstances. That is, in substance, the holding in the *Michelin* case, *supra,* and it is the uniform rule in cases where property is received as compensation for services[20].

To summarize:

1. Even if form is allowed to override substance, so that the acquisition of FNMA stock is considered as a transaction independent of its sale, where the taxpayer's purchases and sales of FNMA stock are frequent and continuous, the result should be that FNMA stock is not a capital asset, and loss from its sale (on the assumption that its cost is its par value) should be deductible against ordinary income.

2. The weight of authority favors an approach where substance is more important than the form. Under this approach, the mortgage sale (a) is either a "boot transaction" under section 1001 of the Internal Revenue Code, and the FNMA stock is taken into account only to the extent of its *market* value, which becomes its tax basis on sale, or (b) involves an ordinary business expense, so that, if the FNMA stock is taken into account at par in computing gain or loss on the mortgage sale, the excess of par over market becomes a deductible expense of doing business, in which case the same tax basis (namely, market value at the time of receipt) would apply.

20. *Hecht v. Com'r*, 16 T.C. 981, and cases there cited.

NO FUNERAL YET

(Continued from page 24)

As previously mentioned, the trend toward welfare-statism and government paternalism is likely to prevent a reversal and tightening of insured loan terms or underwriting. Politicians don't behave that way. But the FHA loan will hold its own nevertheless. Significant indeed was the appearance in the 1961 housing bill of a provision to pay in cash a portion of the government's insurance obligation to the holder of a foreclosed FHA mortgage. Uncle Sugar wants to keep these loans popular with lenders. The builders of the country likewise know, from oft-repeated actions, that the U. S. government is committed to support the housing industry as a benefit to its home-needing citizens, its veterans, and as a counter to recession. This provides a high element of safety for institutions investing in insured loans. These mortgages are unique in being the only private real estate investment medium (together with VA loans) available in quantity, backed by the credit of our national Treasury. I think they are here to stay.

Full Prosperity Ahead

. . . no anemic recovery

***By* WILLIAM F. BUTLER**
Vice President, The Chase Manhattan Bank

AT the moment, business is moving ahead in strong fashion. The recession ended in February. Industrial production has already advanced 6 per cent and should regain its previous peak this summer. Thus, this has been the mildest and shortest of the postwar recessions.

What lies ahead? This is one of those rare occasions when the fine art of business forecasting becomes as simple as shooting fish in a barrel. It is perfectly obvious that we are in a normal recovery period. In the year ahead—from the second quarter of 1961 to the second quarter of 1962—

- Industrial production should rise 12 per cent;
- Gross national product should rise 9 per cent to $556 billion—pause and admire the precision of that forecast;

The number of jobs should expand by 2¾ million.

To see why this sort of a recovery is in prospect, consider trends in the major areas of our economy.

The inventory adjustment is about over. This is important since the main cause of the recession was the shift from adding to inventories in early 1960 at a rate of $11½ billion to cutting them at a rate of almost $5 billion in the first quarter of this year. A shift to building inventories again will add at least $8 billion to the annual rate of production by the second quarter of next year.

The decline in business investment in new plant and equipment, which was very moderate, is about over. Surveys point to an uptrend in the second half. A year from now expenditures should be running at a rate of $52½ billion, an increase of $6½ billion. The emphasis will be on modernization, as the incentives to cut costs are persuasive.

Housing appears to have turned upward after a two-year decline. The easing in mortgage credit, plus the stimulus of the government's new housing program, should lift new housing starts from their present rate of 1.3 million to over 1.4 million a year hence. That means a rise in dollar terms of about $3 billion. This is a much smaller increase than that in previous recovery periods, when housing soared upward 25-30 per cent. The reason is that we've caught up with the backlog of demand for housing—the limiting factor is no longer the supply of mortgage money. It is, rather, the ability of builders to produce an attractive product at an attractive price.

Our net exports may decline by $2 billion in the next year. Imports will rise, while exports may tend to level off or decline if the business boom in Western Europe and Japan tapers off. This is the only major area of the economy where a declining trend is in prospect.

Government expenditures are headed up. We look for an increase of $7 billion in spending by Federal, state and local governments. About half of this will come at the Federal level.

The increase in prospect in the key areas of inventories, plant and equipment, housing and government will add to total income. They should support a rise in the annual rate of personal income after taxes from $361 billion in the second quarter of this year to $388 billion in the second quarter of next year. Thus, over-all consumer purchases of goods and services should increase $25 billion, or 7 per cent.

When you add all these trends together you get a picture of a broadly based, vigorous recovery. To attain by the second quarter of next year a GNP at a rate of $556 billion, and industrial production at 120 on the Federal Reserve Index, will represent a considerable accomplishment.

Yet it will not be good enough. Unemployment will still be 5 per cent of the labor force versus the 4 per cent that represents full employment, We will still not be producing at full capacity.

The problem, then, is whether the expansion will continue through 1962 and carry us back to a full use of our productive resources. That would mean a GNP at a rate of some $580 billion at the end of next year.

We did not achieve a full recovery after the 1957-58 recession. Thus, many forecasters, including the President's Council of Economic Advisers, are fearful that we shall again experience an anemic recovery. In my judgment, such forecasts are wrong —I believe we will achieve a full recovery.

My reasons for this belief fall into two broad categories. First, I think the failure to recover fully in 1959 and 1960 can be explained in large measure by national economic policies that were unduly repressive. We had very tight money—to the point where the money supply actually declined. The Federal budget swung from a large deficit in 1959 to a good-sized surplus in 1960. All of this was very potent deflationary medicine. There were good reasons for the general direction of these policies —we had the problem of inflation.

However, I do not believe we will have policies that are comparably restrictive this year and next. For one thing, the cost of the New Frontier means that we don't have to worry about large budget surpluses. That may very well be the understatement of the day.

A second reason for expecting a full recovery carrying through 1962 and beyond is that basic factors underlying markets for durable goods are swinging to the favorable side. For five years we have been going through a basic adjustment in markets for private durables goods—plant and equipment, housing, autos, appliances, furniture and other consumer durables. The population factor has been unfavorable. We've been adjusting to the end of the period of backlog demand and to a slower growth in stocks of invested capital per worker and housing, autos and other durables per family. Replacement demand has been rising from unusually low levels at the end of the war.

All in all, it seems to me that there are cogent reasons for expecting this recovery to carry us back to a full prosperity level lasting through 1962, and perhaps through 1963 as well.

What could upset this glowing forecast? It seems to me that two things could happen that would change the outlook. One would be a wave of speculation in common stocks. Stock prices are plenty high today. It they go higher, as they could in view of the corporate profits outlook, they will be in a speculative area. The result—a boom and bust in the all too familiar pattern of the past.

Another most disturbing element is developments in the international political arena. I know of no way to predict what is going to happen. But this nation is in the midst of a time of troubles. Developments in Berlin, or in the Far East, or somewhere else could have significant repercussions on the course of business in the United States.

In taking a generally optimistic view of prospects for our economy in the period ahead, I do not wish to imply that everything is rosy, that there are no problems. There are:

▶ **Number One** is to revise our tax system. We place far too heavy a burden on saving and investment, initiative and enterprise. If we are to enjoy prosperity and genuine economic growth, we must over-haul the tax structure. Congress is going to consider this problem next year. It is vitally important that business associations and individual businessmen support realistic tax changes.

▶ Problem **Number Two** is to avoid inflation. To do so we must do three things: Balance the Federal budget in times of prosperity; keep the increase in the money supply in line with the potential growth in real production; and hold wage increases in line with the advance in the economy's efficiency. We've been making progress along these lines, but more must be done. Avoiding inflation is particularly important in helping to bring our international payments into viable balance. This we must do to maintain the integrity of the dollar.

▶ Problem **Number Three** is to improve the quality and quantity of education. We face a great influx of new workers in this decade—some 13 million.

▶ Problem **Number Four** is to secure greater efficiency on the part of business management. Markets are going to be tough and competitive in the decade ahead. This is as it should be. But it means that busines must do an even better job.

▶ Problem **Number Five** involves our role in the world economy. This is a large and complex subject—but it is important since failure to meet our international responsibilities could jeopardize our domestic prosperity. We must keep our balance of payments under control, and we must develop new international financial mechanisms to guard against a world financial crisis. We must move steadily in the direction of expanding world trade—and we must support international development, through private foreign investment to the maximum possible extent.

There are other problems beyond these five—rehabilitating our cities; overhauling our farm program; getting the railroads back on their feet; and securing more efficient public administration. YET the five problems I have singled out strike me as the real economic challenges of the 1960s.

If the nation can measure up to these challenges, I believe we face an era of unprecedented growth.

People : Places : Events

Howard J. Ludington, president, H. J. Ludington, Inc., was appointed to the board of trustees of Cornell University by Governor Nelson A. Rockefeller. Mr. Ludington, of the Cornell Class of 1917, will serve for five years. For the past two years he has been a member of Cornell University Council and since graduation has been an active alumni in Upstate New York. Over the years he has served on a long list of committees in connection with the school and is chairman for the 45th reunion of the Class of 1917, coming up next year. In addition to the presidency of H. J. Ludington, Inc., he is president of H. J. Ludington Investors Inc., nationally known mortgage brokerage company.

H. J. Ludington

A realignment and promotion of officers of White Investment Company, Minneapolis, was announced by **R. H. White,** president of the 78-year old mortgage banking firm. Elected secretary and vice-president in charge of mortgage loans is **R. J. White. W. B. White** is now vice-president in charge of construction and land development.

R. J. White

W. B. White

The M. P. Crum Company, Dallas, announced three promotions to its executive staff. **Norman Luterman** has been named vice president, **Mayo Crum,** treasurer, and **Lester L. Blakely Jr.,** assistant vice president. **Thomas M. Andrews** has joined the residential loan department. **Paul Crum** is president of the firm, and **James B. Biddle** executive vice president.

Luterman Crum Blakely

J. Hunter Hardesty has been named vice president of First Akron Corporation, Arkon, **John B. Hunter,** president, announced. He's a graduate of the MBA School of Mortgage Banking of Northwestern University.

Nels G. Severin, president, Palomar Mortgage Company, San Diego, announced the election of **John W. Hanson,** vice president—operations; **George R. Hallaran,** assistant vice president and branch manager (Riverside); **Lee J. Wittwer,** assistant vice president and branch manager (Las Vegas) and **Robert H. Westbrook** as a director.

John W. Hanson

Key Investment Company, Odessa, Texas announced some promotions in its executive staff with **Jim Key,** president, moving up to chairman and **W. C. Brown** being named president. **B. B. Story** was moved from controller to executive vice president; **Alex Zotos** from vice president to senior vice president and **J. L. Rhoades** was also named senior vice president.

Lowell S. Fenton has joined Dwyer-Curlett and Co., Los Angeles, as a loan officer in the commercial loan department, **Roger C. Olson,** executive vice president, announced.

Fenton served in the city loan department of Equitable Life for more than seven years.

Lowell S. Fenton

Joel G. Brown was named comptroller of J. I. Kislak Mortgage Corporation of Florida.

He joined the firm after more than 14 years in the Florida mortgage and accounting fields.

George I. Wilson has been named a vice president in charge of mortgage servicing of United Mortgage Servicing Corp. in Norfolk, **David S. Loeb,** president, announced. He was formerly with Eastern Mortgage Service Company in Philadelphia and later with Colonial Mortgage Service Company in Upper Darby, Pennsylvania.

Paul L. Dotson has been named assistant secretary of Colonial Group, Inc. in charge of the Company's Newport News office.

A former MBA president, **Guy T. O. Hollyday** and one-time FHA commissioner, was chairman of the group which was named by Charleston, West Virginia to make a study of the city's housing problems.

C. F. Childs and Company, Inc., oldest investment firm in the country specializing in government securities, announced the election of **Clarence W. Ostema** and **Frederick J. Close** as vice presidents of Childs Securities Corporation, its subsidiary dealing in corporate and mortgage finance.

Mr. Ostema is well known to mortgage bangers as the first to make a market in FNMA common stock and FHA debentures. Mr. Close is one of the nation's foremost specialists in Capehart financing and in other large FHA loans.

C. W. Ostema

Arnold Fleer

Arnold Fleer has joined the Savill-Mahaffey Mortgage Company, Inc., Indianapolis, as assistant vice president in the commercial loan department. For the past ten years he was with the Mercantile Mortgage Company and prior to that was assistant vice president of their Indianapolis branch.

John M. Dervan, assistant director since 1955, has been appointed director of VA's Loan Guaranty Service. He succeeds **Philip N. Brownstein,** recently named chief benefits director. Dervan joined VA in 1945 and has held progressively responsible positions in the Loan Guaranty Service as legal advisor, chief of the legislative and regulatory staff, assistant director for loan policy and management, and acting director before his appointment as director. Prior to World War II, he was a member of the legal staff of HOLC and the Federal Savings and Loan Insurance Corporation.

John M. Dervan

As top man in VA's Loan Guaranty Service, he directs the GI loan program under which the agency has guaranteed or insured almost six million home, farm, and business loans for veterans with a total value exceeding $50 billion, and has made almost 187,000 direct home loans to veterans totaling more than $1.5 billion.

H. Alpheus Drake, Jr., well-known nationally in mortgage banking because of his long association with Liberty National Life Insurance Company of Birmingham, has joined Robinson Mortgage Company in that city as vice president . . . **Herbert A. Lund,** mortgage loan supervisor for Northwestern National Life Insurance Company, Minneapolis, has been elected a director of Security State Bank of Albert Lea, Minnesota. He was formerly vice president of Conservative Bond and Mortgage Co., Sioux Falls, S. D. . . . **Bert G. Stalford,** vice president and mortgage officer of Fidelity Bank, Beverly Hills and Los Angeles, was named to the institution's board . . . **Emanuel M. Brotman,** chief executive officer of J. I. Kislak Mortgage Corp., Newark, has been named a vice president of the parent company, J. I. Kislak, Inc. and **Peter Hirschmann** has been elected secretary of the parent company.

Roger A. Nelson, vice president, Moore Mortgage Co., Denver and president of the Denver MBA, has been elected president of the Retail Credit Men's Association of Greater Denver . . . **Ivan C. Peck,** who went from Denver to Hawaii in recent years to become associated with the Honolulu Trust Company, Ltd., has been named president of that institution . . . **Robert Sutro** of Ralph C. Sutro Co. in Los Angeles, now holds the double post of president and board chairman of his institution . . . **D. Richard Mead, Jr.,** president of D. R. Mead & Co., Miami, was recently elected to membership in the Young Presidents' Organization, a nation-wide group of just what its name implies, young presidents who have attained the top rung of the ladder while still in their 20s and 30s. The average president's company employs around 300 people, has a $6 million gross business . . . **David H. Solms,** president, Colonial Mortgage Service Company, Upper Darby, Pennsylvania, is serving as a trustee of the newly-organized Pennsylvania Real Estate Investment Trust, which was launched in June with a public offering of stock to Pennsylvania residents.

Edward J. Thomas has been elected president of the Saving Fund Society of Germantown, Philadelphia, to succeed **Stanley H. Heist** . . . Tharpe & Brooks Incorporated of Atlanta opened a new branch in Athens, the fourth for this company.

Dennis H. Michaels has joined the staff of Franklin Mortgage Corporation, Detroit, and will be in charge of the closing department. **Robert J. Cerwin,** secretary and manager of the closing department, is being promoted to vice president and secretary.

J. Robert Cannon has joined Murphree Mortgage Company, Nashville as vice president. He had fifteen years experience in the mortgage business starting with Prudential and was recently with Provident Mutual Life Insurance Company where he held the position of assistant manager of mortgage loans and real estate.

Obituary

With deep regret we record the death of Kenneth J. Morford, chairman of Burwell & Morford of Seattle, one of the oldest mortgage banking firms in the country. He was an MBA regional vice president and had long served on the Association's board of governors. Burwell & Morford was founded by Mr. Morford's father and he joined the firm in 1922. He was a trustee of the Puget Sound Mutual Savings Bank, a former vice president of the Seattle Real Estate Board and recently headed a Seattle's citizens committee studying the finances and services of Seattle public schools. He was a former chairman of the Seattle Housing Authority and recently was named to the executive board of Chief Seattle Council, Boy Scouts of America.

Harold F. Yegge, for many years associated with Kransz-Neuses Mortgage Co. in Chicago, has joined the Real Estate Research Corporation in Chicago.

William S. Hedley has been elected a vice president of The Greater New York Savings Bank in Brooklyn. He began as a clerk in the Mortgage Department.

Individuals Buying More FHA Mortgages

FHA's program for sales of loans to individuals hasn't exactly made a big dent in the field of mortgage investment but it is growing.

An increasing interest by individuals, pension funds, and union funds is apparent in the results of a recent FHA survey.

FHA regulations were amended on July 13, 1960 to make it possible for the first time for individuals and organizations other than FHA-approved mortgagees to own mortgages on one- to four-family homes insured under Section 203(b). An initial survey of sales activity was made on September 30, 1960, and the second and latest was made on March 31, 1961.

On the latter date, 2,252 mortgages totaling $27.9 million had been sold to investors in the new category. The amount sold was more than nine times as great as the $3 million sold through September 30.

Of the March 31 total, $21.3 million was held by pension and union funds and $5.3 million by 403 individuals. In the 6 months between the first and second surveys, the total number of investors increased from 149 to 507. During the same period, the proportion held by pension and trust funds, increased from a little more than half to 75 per cent of the total amount, and the proportion held by individuals declined from about 37 per cent to 19 per cent.

The number of approved mortgagees selling the mortgages increased from 58 at September 30 to 168 at March 31. Mortgage companies have sold more than $17.6 million, State banks $6.6 million, and national banks $2.8 million.

When an insured mortgage is sold by an approved mortgagee to an individual or fund purchaser, the approved mortgagee continues to service the mortgage and to be responsible for payment of insurance premiums and taxes and for settlement of mortgage insurance claims with FHA.

PERSONNEL
AND BUSINESS NEEDS

In answering advertisements in this column, address letters to box number shown in care of The Mortgage Banker, 111 West Washington Street, Chicago 2, Illinois.

MORTGAGE OFFICER
COMMERCIAL LOANS

Excellent opportunity for qualified man to take charge of commercial loan department of large, progressive mortgage banking firm in business more than 25 years in Washington, D. C. Must be senior man with experience handling all types of commercial loans, including origination and placement with insurance companies and other institutional investors. Must be aggressive, able to supervise work of others. Position provides for excellent income, pension and profit sharing plans, and all other usual benefits. Our employees have been advised of this ad. Reply in strict confidence to Box 741.

Large midwest mortgage banking firm would like to hire experienced income property loan man. Excellent opportunity for qualified man. Submit full experience and background. Salary open. Write Box 744.

COMMERCIAL LOAN MAN

Large progressive mortgage correspondent desires young man as appraiser and mortgage man to concentrate on commercial type properties for insurance company lenders in Los Angeles area. Excellent growth opportunity and fringe benefits. Send complete résumé to Box 742.

EXPERIENCED APPRAISER and mortgage man wanted by leading Midwestern mortgage banking firm. New position as aide to senior vice president. Qualified man can command five-figure salary to start. Must have experience in processing and submitting applications involving income properties. Unexcelled opportunity in live, progressive multi-office company with over 100 millions in mortgage servicing accounts. In first letter give complete résumé of experience, education, present employment status, availability. All replies will be answered and held strictly confidential. Address Box 743.

EXPERIENCED EXECUTIVE

To head up mortgage loan division of successful, diversified corporation in Kansas. Submit complete résumé and salary requirements. Write Box 745.

Outstanding mortgage brokerage organization in New York City wishes to add a top-flight experienced negotiator to its staff to cover lending institutions. Write Box 746.

This column, and this page, represent a market-place for personnel in the mortgage banking field. The cost of an advertisement in this column is 60¢ per word and replies are treated in strict confidence. Use these facilities when you have a personnel problem to solve.